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The Economist

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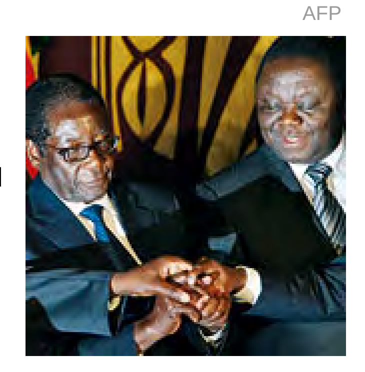
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Politics this week

Sep 18th 2008
From The Economist print edition

AFP



A deal was signed in **Zimbabwe** to provide for a national unity government, with Robert Mugabe staying on as executive president and Morgan Tsvangirai, his bitter opponent, becoming the executive prime minister. It was unclear who would ultimately be in charge or how the deal would work. See article

A court in **South Africa** ruled that the National Prosecuting Authority had failed to follow correct procedure in its corruption case against Jacob Zuma, who heads the African National Congress and will probably be the next national president, so his trial could not take place. The judge also criticised the country's embattled president, Thabo Mbeki, for seeking to influence the prosecution of Mr Zuma, his rival. See article

Tzipi Livni, the foreign minister, won a primary contest to replace the prime minister, Ehud Olmert, as leader of Kadima, the party that heads **Israel's** coalition government. But she will have to haggle to reshape the coalition in order to become prime minister, a post Mr Olmert will in the meantime continue to hold. See article

The IAEA, the UN's nuclear guardian, reported that **Iran** has failed to co-operate fully with inspectors trying to investigate its past alleged nuclear-weapons work and meanwhile continues to enrich uranium, despite UN Security Council instructions to stop.

General David Petraeus took over the United States Central Command that covers the wider Middle East, including Afghanistan, some 21 months after overseeing a military "surge" of troops into Iraq that is credited with helping to reduce violence sharply there.

A jihadist group set off a bomb near the American embassy in **Yemen**, killing at least 16 people, mainly locals. The country has recently witnessed an increase of violence.

Keeping it in the family

Somchai Wongsawat became prime minister of **Thailand**, replacing Samak Sundaravej, who was ordered by the courts to stand down because his appearances as a television chef breached the constitution. Protesters have been campaigning for Mr Samak's resignation for being too close to Thaksin Shinawatra, the prime minister deposed in a coup in 2006. Mr Somchai is Mr Thaksin's brother-in-law.

It emerged that more than 6,000 infants in **China** were made sick, and four died, from consuming milk powder tainted with melamine, a chemical used to make plastic. The authorities were accused of acting too slowly after the contamination became known, so that the scandal did not cast a shadow over last month's Beijing Olympics. See article

AFP



A series of bombs exploded in shopping areas of **Delhi**, killing at least 20 people. As with recent attacks in Jaipur and Bangalore a group calling itself the Indian-Mujahideen claimed responsibility.

The United Nations pulled its staff out of parts of northern **Sri Lanka** held by the rebel Liberation Tigers of Tamil Eelam, after the government said it could not guarantee their safety.

Anwar Ibrahim, leader of **Malaysia's** opposition, claimed that enough ruling-coalition parliamentarians were ready to switch sides to enable him to form a government. But he did not name them and the prime minister, Abdullah Badawi, ridiculed the claim. See article

NATO nyet

Russia signed friendship treaties with South Ossetia and Abkhazia that include a promise of military assistance for the breakaway Georgian regions. Earlier, a NATO delegation consisting of representatives from all 26 member countries paid a visit to **Georgia**. Attempts by Georgia to join the Atlantic alliance have met stiff resistance from Russia. It criticised NATO for displaying a "them and us" mentality.

Ukraine's ruling coalition officially fell apart. Viktor Yushchenko, the president, is embroiled in a long-running dispute with Yulia Tymoshenko, the prime minister, the latest episode of which was a plan to trim his presidential powers. If parliament fails to form a new government in a month, Mr Yushchenko can call an election. See article

A few junior members of the government staged a mini-revolt and tried to force **Britain's** beleaguered prime minister, Gordon Brown, to step down. But the cabinet, including David Miliband, the foreign secretary, a putative leadership contender, remained loyal. See article

Highlands and lowlands

After weeks of deadly clashes between pro- and anti-government demonstrators in **Bolivia** over proposed constitutional reforms, opposition governors from the rich eastern region agreed to talks with the government in an effort to find a way out the crisis. See article

At least seven people were killed and more than 100 injured when explosions tore through a crowd celebrating **Mexico's** independence day in Morelia, capital of Michoacán, a state long plagued by drug-gang violence. The cause of the blasts remains unclear.

Cuba suffered what the government described as the worst damage in the island's history after being struck by hurricanes Gustav and Ike. It nevertheless turned down an offer of aid from the United States. See article

Texan trail

Hurricane Ike continued its destructive path, forcing an (orderly) evacuation along the Texas coast. George Bush went to the area to view the damage. See article

America's House of Representatives passed a bill that would expand **oil-drilling** in areas at least 50 miles (80km) off the Atlantic and Pacific coasts. This marked a change in Democratic attitudes to drilling, though Republicans still argue for expanding it closer to the coasts and in the Gulf of Mexico. A current ban on expansion ends at the end of September. The measure now heads to the Senate.

Getty Images

A commuter train collided with a freight train in a **Los Angeles** suburb, killing 26 people. It was America's worst rail disaster in 15 years. Federal authorities said they were investigating claims that the driver of the commuter train was distracted by writing a text message on his phone.

In an unparalleled move, **California's** governor, Arnold Schwarzenegger, said he would veto the state budget because it did not include strong provisions for times of fiscal trouble. Legislators had just reached a compromise on the legislation, 78 days into the start of California's fiscal year.

Business this week

Sep 18th 2008
From The Economist print edition

A momentous week for global markets recast America's financial system. At an emergency meeting convened by the Federal Reserve Bank of New York on September 12th, Treasury officials declined to back **Lehman Brothers**. With its potential rescuers, Bank of America and Barclays, scared off, the investment bank sought bankruptcy protection. See article

Dovetailing with Lehman's woes, **Merrill Lynch** said it had struck a deal with **Bank of America** and was being bought for $50 billion, half its value early last year.

On September 15th rating agencies downgraded **American International Group**, until recently the world's biggest insurer, forcing it to hand over some $14 billion in collateral to holders of its debt. As AIG's share price slumped, and amid worries that its failure would be worse than anything the markets had yet seen in the crisis, the federal government seized control, lending AIG $85 billion and taking an 80% equity stake. See article

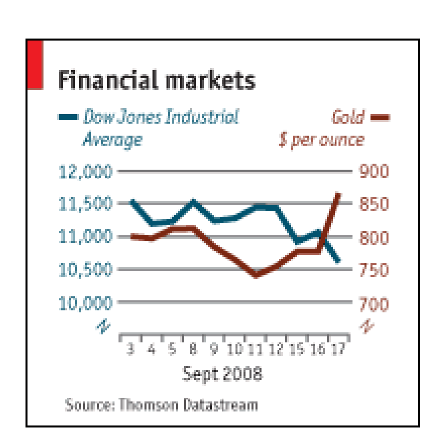
Panic spread to other banks, too. The day after AIG's rescue, **Morgan Stanley** and **Goldman Sachs** saw their shares hammered by 24% and 14% respectively. They are Wall Street's only remaining large investment banks, though Morgan Stanley is said to be looking for a buyer, as is **Washington Mutual**, which had its credit-rating downgraded to junk status. See article

HBOS, Britain's biggest mortgage-lender was taken over by **Lloyds TSB**, creating a behemoth in British banking with almost a third of the retail and mortgage markets. Competition regulators would normally balk at such a deal, but the rescue was supported by the government. See article

America's Securities and Exchange Commission issued rules designed to stop traders **short-selling** stocks that they have not borrowed—a practice some blame for driving down financial shares in the turmoil.

The rates on loans that banks charge each other rapidly rose in the turmoil. The London interbank offered rate, or **LIBOR**, jumped by 3.33 percentage points, to 6.44%, on its overnight dollar rate, its biggest increase ever. **Reserve Primary**, the oldest American money-market fund, became the first in 14 years to cause its investors to lose money, because of Lehman's default.

Stockmarkets tumbled on Wall Street's troubles, resulting in the worst losses since the aftermath of September 11th 2001. Yields on three-month Treasury bills fell to their lowest level since daily records began in 1954. Trading was suspended on **Russia's** stockmarkets when they went into a free-fall that was not halted even by a government injection of $44 billion into the country's three biggest banks. See article



Investors sought shelter elsewhere. **Gold prices**, which had been falling, recorded huge one-day gains in dollar terms on September 17th. **Oil prices**, which had been hurtling down towards $90 a barrel, also shot up.

On September 18th the Federal Reserve, Bank of England, European Central Bank, Bank of Japan and other central banks co-ordinated their response to the situation and pledged to inject up to $180 billion to boost liquidity.

In other news

Porsche increased its stake in **Volkswagen** to over 35%, giving it "de facto control" of Europe's biggest carmaker. Porsche has already made public its plan to raise its stake to above 50%, and bring the two companies together. However, the plan is being resisted by VW's powerful unions and by the German state of Lower Saxony, VW's second-largest shareholder.

Germany's **BASF**, the world's biggest chemical company, made a friendly bid for **Ciba**, a Swiss rival that specialises in plastics additives, coatings and water and paper treatment. The deal is valued at SFr3.5 billion ($3.1 billion).

Hewlett-Packard said it would cut almost 25,000 jobs as it pushes forward its integration with Electronic Data Systems, which it bought earlier this year. The number of job losses, around half of which will be in the United States, was much larger than many analysts had expected.

Dell's share price slid to a ten-year low when it forecast a "further softening" in demand for information technology.

South Korea's **Samsung Electronics** unveiled an offer of almost $6 billion for **SanDisk**, which the Californian company rejected. Samsung pays SanDisk more than $350m a year to use its patented flash-memory technology.

BAA decided to put **Gatwick** up for sale. A recent report from Britain's Competition Commission recommended that BAA sell two of its three London airports. It is keeping Heathrow, but is resisting putting Stansted on the block.

KAL's cartoon

Sep 18th 2008
From The Economist print edition

Illustration by KAL



The financial crisis

What next?

Sep 18th 2008
From The Economist print edition

Global finance is being torn apart; it can be put back together again

Illustration by Oliver Burston



FINANCE houses set out to be monuments of stone and steel. In the widening gyre the greatest of them have splintered into matchwood. Ten short days saw the nationalisation, failure or rescue of what was once the world's biggest insurer, with assets of $1 trillion, two of the world's biggest investment banks, with combined assets of another $1.5 trillion, and two giants of America's mortgage markets, with assets of $1.8 trillion. The government of the world's leading capitalist nation has been sucked deep into the maelstrom of its most capitalist industry. And it looks overwhelmed.

The bankruptcy of Lehman Brothers and Merrill Lynch's rapid sale to Bank of America were shocking enough. But the government rescue of American International Group (AIG), through an $85 billion loan at punitive interest rates thrown together on the evening of September 16th, marked a new low in an already catastrophic year. AIG is mostly a safe, well-run insurer. But its financial-products division, which accounted for just a fraction of its revenues, wrote enough derivatives contracts to destroy the firm and shake the world. It helps explain one of the mysteries of recent years: who was taking on the risk that banks and investors were shedding? Now we know.

Yet AIG's rescue has done little to banish the naked fear that has the markets in its grip. Pick your measure—the interest rates banks charge to lend to each other, the extra costs of borrowing and of insuring corporate debt, the flight to safety in Treasury bonds, gold, financial stocks: all register contagion. On September 17th HBOS, Britain's largest mortgage lender, fell into the arms of Lloyds TSB for a mere £12 billion ($22 billion), after its shares pitched into the abyss that had swallowed Lehman and AIG. Other banks, including Morgan Stanley and Washington Mutual, looked as if they would suffer the same fate. Russia said it would lend its three biggest banks 1.12 trillion roubles ($44 billion). An American money-market fund, supposedly the safest of safe investments, this week became the first since 1994 to report a loss. If investors flee the money markets for Treasuries, banks will lose funding and the contagion will suck in hedge funds and companies. A brave man would see catharsis in all this misery; a wise man would not be so hasty.

The blood-dimmed tide

Some will argue that the Federal Reserve and the Treasury, nationalising the economy faster than you can say Hugo Chávez, should have left AIG to oblivion. Amid this contagion that would have been

reckless. Its contracts—almost $450 billion-worth in the credit-default swaps market alone—underpin the health of the world's banks and investment funds. The collapse of its insurance arm would hit ordinary policyholders. At the weekend the Fed and the Treasury watched Lehman Brothers go bankrupt sooner than save it. In principle that was admirable—capitalism requires people to pay for their mistakes. But AIG was bigger and the bankruptcy of Lehman had set off vortices and currents that may have contributed to its downfall. With the markets reeling, pragmatism trumped principle. Even though it undermined their own authority, the Fed and the Treasury rightly felt they could not say no again.

What happens next depends on three questions. Why has the crisis lurched onto a new, destructive path? How vulnerable are the financial system and the economy? And what can be done to put finance right? It is no hyperbole to say that for an inkling of what is at stake, you have only to study the 1930s.

Shorn of all its complexity, the finance industry is caught between two brutally simple forces. It needs capital, because assets like houses and promises to pay debts are worth less than most people thought. Even if some gain from falling asset prices, lenders and insurers have to book losses, which leaves them needing money. Finance also needs to shrink. The credit boom not only inflated asset prices, it also inflated finance itself. The financial-services industry's share of total American corporate profits rose from 10% in the early 1980s to 40% at its peak last year. By one calculation, profits in the past decade amounted to $1.2 trillion more than you would have expected.

This industry will not be able to make money after the boom unless it is far smaller—and it will be hard to make money while it shrinks. No wonder investors are scarce. The brave few, such as sovereign-wealth funds, who put money into weak banks have lost a lot. Better to pick over their carcasses than to take on their toxic assets—just as Britain's Barclays walked away from Lehman as a going concern, only to swoop on its North American business after it failed.

The centre cannot hold

Governments will thus often be the only buyers around. If necessary, they may create a special fund to manage and wind down troubled assets. Yet do not underestimate the cost of rescues, even necessary ones. Nobody would buy Lehman unless the government offered them the sort of help it had provided JPMorgan Chase when it saved Bear Stearns. The nationalisation that, for good reason, wiped out Fannie's and Freddie's shareholders has made it riskier for others to put fresh equity into ailing banks. The only wise recapitalisation just now is an outright purchase, preferably by a retail bank backed by deposits insured by the government—as with Bank of America and Merrill Lynch, Lloyds and HBOS and, possibly, Wachovia with Morgan Stanley. The bigger the bank, the harder that is. Most of all, each rescue discourages investors from worrying about the creditworthiness of those they trade with—and thus encourages the next excess.

For all the costs of a rescue, the cost of failure to the economy would sometimes be higher. As finance shrinks, credit will be sucked out of the economy and without credit, people cannot buy houses, run businesses or as easily invest in the future. So far the American economy has held up. The hope is that the housing bust is nearing its bottom and that countries like China and India will continue to thrive. Recent falls in the price of oil and other commodities give central banks scope to cut interest rates—as China showed this week.

But there is a darker side, too. Unemployment in America rose to 6.1% in August and is likely to climb further. Industrial production fell by 1.1% last month; and the annual change in retail sales is at its weakest since the aftermath of the 2001 recession. Output is shrinking in Japan, Germany, Spain and Britain, and is barely positive in many other countries. On a quarterly basis, prices are falling in half of the 20 countries in *The Economist*'s house-price index. Emerging economies' stocks, bonds and currencies have been battered as investors fret that they will no longer be "decoupled" from the rich countries.

Unless policymakers blunder unforgivably—by letting "systemic" institutions fail or by keeping monetary policy too tight—there is no need for today's misery to turn into a new Depression. A longer-term worry is the inevitable urge to regulate modern finance into submission. Though understandable, that desire is wrong and dangerous—and the colossal success of commerce in the emerging world (see article) shows how much there is to lose. Finance is the brain of the economy. For all its excesses, it allocates resources to where they are productive better than any central planner ever could.

Regulation is necessary, and much must now be done to improve the laws of finance. But it must be the

right regulation: an end to America's fragmented system of oversight; more transparency; capital requirements that lean against booms and flex with busts; supervision of giants, like AIG, that are too big and too interconnected to fail; accounting that values risks better and that everyone accepts; clearing houses and exchanges to make derivatives safer and less opaque.

All that would count as progress. But naive faith in regulators' powers creates ruinous false security. Financiers know more than regulators and their voices carry more weight in a boom. Banks can exploit the regulations' inevitable blind spots: assets hidden off their balance sheets, or insurance (such as that provided by AIG) which enables them to profit by sliding out of the capital requirements the regulators set. It is no accident that both schemes were at the heart of the crisis.

This is a black week. Those of us who have supported financial capitalism are open to the charge that the system we championed has merely enabled a few spivs to get rich. But it helped produce healthy economic growth and low inflation for a generation. It would take a very big recession indeed to wipe out those gains. Do not forget that in the debate ahead.





Global business

In praise of the stateless multinational

Sep 18th 2008
From The Economist print edition

Not without its flaws, but infinitely preferable to the state-bound version

Illustration by James Fryer



IF YOU hanker after the idealistic spirit of international co-operation, talk to the boss of an emerging-market multinational. Not the boss of Gazprom, perhaps, which has behaved like an arm of the Russian state. But try Chairman Yang Yuanqing of Lenovo, who has moved his family to North Carolina to deepen his appreciation of American culture, so as to help him integrate his Chinese and American workers. Or Lakshmi Mittal, the London-based Indian boss of Arcelor Mittal, who says his multinational team of executives get on so well that he forgets there are different nationalities in the room, and who believes his firm has no nationality, instead being "truly global".

Lenovo and Arcelor Mittal are at the leading edge of a new phase in the evolution of the multinational corporation, as our special report this week argues. At first companies set up overseas sales offices, to watch over the export of goods made at home. Then they built small foreign replicas of the mother ship, to cater to local demand. Today the goal is to create what Sam Palmisano, the boss of IBM, calls the "globally integrated enterprise"—a single firm in which work is sourced wherever it is most efficient.

For business leaders, building a firm that is seamlessly integrated across time zones and cultures presents daunting obstacles. Rather than huddling together in a headquarters building in Armonk or Millbank, senior managers will increasingly be spread around the world, which will require them to learn some new tricks.

How do you get virtual teams of workers to bond, for instance? The answer seems to be a lot of time spent talking—as well as the odd junket. MySQL, an online database firm, holds virtual Christmas parties, at which teams around the world play games and exchange virtual gifts. And what about overcoming all those awkward cultural differences? Lenovo, for example, has had to encourage normally reticent Chinese workers to speak candidly in meetings with American colleagues.

Some people assume that stateless multinationals inevitably compete away standards in a race to the bottom. It is true that multinationals tend to shop around for taxes, but in other ways they are usually sticklers for good behaviour. Encouragingly, firms from emerging markets are finding that a globally integrated company needs a single culture, and that the best way to foster this is to make the highest ethics anywhere in the firm the norm for everyone, wherever they are working. Anything less tends to corrode the culture.

A globally integrated firm cannot allow corrupt practices by employees in some countries and not others, so it must outlaw them everywhere. On the other hand, it cannot enforce religious practices and

holidays, or different ways of life, so it must preach tolerance. One investment bank, for example, is extending its lesbian, gay, bisexual and transgender network to its Indian operations over the opposition of its local boss.

Flag-wavering

In fact, the real threat comes from overly chummy links between a state and its multinationals. Although politicians may have been more comfortable in a world where what was good for General Motors was good for America, that tended to lead to protectionism and antiquated working practices. Firms in which loyalty to the state goes beyond the economic value it offers usually expect something in return—soft contracts and subsidies, perhaps, or standards conveniently set in their interest. In fact the sorry story of GM itself highlights the dangers of being a national champion. Rather than fear the stateless corporation, people would be wise to do all they can to make them feel at home in their country.



OPINION LEADERS

Defeating the Taliban

FATA morgana

Sep 18th 2008
From The Economist print edition

America will not win the war in Afghanistan by taking it across the border into Pakistan's tribal areas

Reuters



Get article background

ALLIED gloom about the war in Afghanistan tends to be seasonal. The hopes of spring are dented by a summer of roadside explosions, suicide-bombings and ambushes. But this autumn they have nearly been dashed altogether. Violence is at its highest level since the toppling of the Taliban in 2001. The chairman of America's joint chiefs of staff, Admiral Mike Mullen, has admitted he is "not convinced we're winning it" in Afghanistan. On the ground the mood is bleaker. Foreign aid-workers in Kabul feel under siege. Generals grumble about needing thousands more soldiers. Some diplomats seem close to despair. For those hoping Afghanistan can soon achieve peace and stability, these are desperate times.

One desperate measure adopted by America in response has been to attack the presumed bases in Pakistan's tribal areas from which militants mount cross-border operations (see article). Since Pakistan is failing to live up to its promise to deny the insurgents sanctuary, exasperated American generals have decided to act themselves. But launching attacks in Pakistan in defiance of its government is counterproductive.

On September 3rd American commandos mounted an attack in South Waziristan, part of Pakistan's semi-autonomous Federally Administered Tribal Areas (FATA). Pakistanis say another incursion this week was repulsed, though both armies deny it. Certainly, American forces have been stepping up strikes. There have been a dozen in a fortnight.

Anti-American sentiment in Pakistan is easily provoked, and it is hard to imagine greater provocation. The government, which says the American attacks have cost civilian lives, has been fiercely critical of them. Worse, there are suspicions in Pakistan that their timing was influenced by the political calendar in Washington. The Bush administration, it is thought, is impatient for an "October surprise" in the form of the killing or capture of al-Qaeda bigwigs hiding in the FATA.

Even if these suspicions are groundless, unilateral cross-border attacks, which appear to have killed no "high-value targets", are a bad idea. In Afghanistan itself the Taliban have been adept at duping foreign forces into becoming their recruiters through the killing of civilians. In the FATA there is the same risk: that the raids end up making the local population—and the rest of Pakistan—even more hostile to America. They certainly undermine the fragile new civilian government of President Asif Zardari. To be treated with such contempt by an ally weakens Mr Zardari's standing at home, and makes Pakistan's army—never tolerant of civilian direction—even less likely to heed the government.

Federally administer the tribal areas

Yet it is true that Afghanistan will never know peace while the tribal areas provide a haven for insurgents. Force will be part of the solution. But, as Mr Zardari knows, there also needs to be a comprehensive plan to develop the region—building roads and providing buses, schools and hospitals, but also dismantling the terrorist infrastructure and, eventually, integrating the FATA fully into Pakistan proper. America's cross-border pressure may have been intended in part to impress upon Pakistan's leaders the urgency of the military aspect.

If so, it has probably worked, and the Americans may now ease off. Indeed, Admiral Mullen, visiting Islamabad on September 17th, promised to respect Pakistani sovereignty. But Pakistan's foreign minister complained that an American drone attack in North Waziristan that day had again been undertaken without consultation. Pakistanis will still need persuading that the fight against extremists is their war, as well as America's. Admiral Mullen's soothing words were but a start.

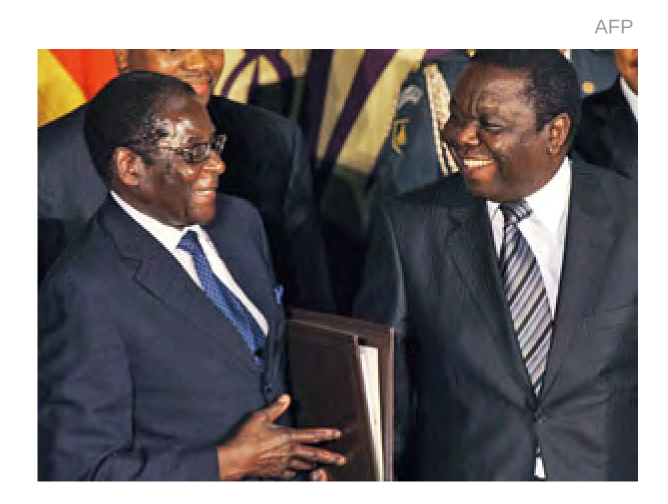
Zimbabwe

Give a bad deal a chance

Sep 18th 2008
From The Economist print edition

Robert Mugabe is no longer omnipotent, but it will still be hard to get rid of him altogether

AFP



THE document that provides for a government of national unity to end Robert Mugabe's tyranny in Zimbabwe is riddled with contradictions and ambiguities (see article). No one knows whether it will work. If justice had anything to do with it, Morgan Tsvangirai, having won a general election and the first round of a presidential one at the end of March on a playing field tilted like a ski-jump in favour of the incumbent, would be indisputably in charge. But the agreement, signed in Zimbabwe this week under the aegis of South Africa's President Thabo Mbeki, is a dramatic turning point all the same. Mr Mugabe is no longer wholly in charge. That is a huge change. The task now for Zimbabweans and outsiders who wish them well is to try, against the odds, to make a bad deal work.

The nub of the push-me-pull-you arrangement is that Mr Mugabe is due to remain an executive president, with Mr Tsvangirai an executive prime minister. A cabinet headed by Mr Mugabe is meant to draw up policy, while a parallel council of ministers, headed by Mr Tsvangirai, is meant to implement it. In the 31-person cabinet Mr Tsvangirai's Movement for Democratic Change and a small splinter group from the same party, which have often been bitterly at odds, will together have a majority of one over Mr Mugabe's ZANU-PF. The unity document says that cabinet decisions should be agreed on by consensus. Mr Mugabe will appoint ministers "in consultation with" Mr Tsvangirai, but it is unclear how a deadlock here, as in many other aspects of the deal, will be resolved. There is no strong arbitrating mechanism for knocking heads together.

As *The Economist* went to press, the allocation of ministries had yet to be settled. The word is that Mr Tsvangirai's team will, among others, get the ministries of finance and home affairs, including the police and prisons. Mr Mugabe and his ZANU-PF will still control the army and probably the feared intelligence service. In sum, unless there is a sudden effusion of goodwill on all sides, the deal could be a recipe for confusion and paralysis.

Target the aid, hail the incentives

Help from the West, especially the European Union and the United States, will be crucial. The momentum is behind Mr Tsvangirai, however hobbled by the provisions of the dodgy document. First of all, Westerners must save Zimbabweans from starvation. It will soon be clear, as an early test of the government's unity, whether Mr Mugabe's people will allow a fast and fair distribution of food, which they have previously prevented. Next, outsiders must help stabilise a currency whose annual inflation rate may have surpassed 40m%; not an easy task. A currency board may need to be set up, with a new currency probably pegged, at least at first, to the South African rand.

At the same time, with the MDC having secured one of its men as Parliament's agenda-setting speaker, Mr Tsvangirai should rapidly enact a string of changes to engender a new mood of freedom. He should abolish the Public Order and Security Act, a bedrock of repression that has hamstrung opposition, and strike down a media law that has stifled open discussion and dissent. He should immediately overhaul the state broadcaster, which has been a virulent mouthpiece for Mr Mugabe. And he should instantly allow Western reporters back into the country. Just as promptly, he needs to set up a land commission, produce an early audit of who owns the land and arrange a proper system of compensation, with help from Britain, for those who have lost it. White farmers will not return en masse, but some should be encouraged to come back and rebuild Zimbabwe's agriculture, the heart of its economy, with offers of leaseholds and management contracts.

However shoddy the deal that has been done, Mr Tsvangirai can make a difference. The faster he can make these minimal changes, the faster foreign aid will come and the faster the country will revive. But the aid must be accurately directed, step by step, depending on how well it is used, and not disbursed in a hectic rush or via the crooked ZANU-PF channels of yore. Mr Mugabe and his sullen cronies, who have long assumed that the state and the ruling party are one and the same, may seek to divert the aid and dispense their patronage as before, in the hope that Mr Tsvangirai will soon get the blame.

Mr Mugabe is clever and malevolent. Mr Tsvangirai is dogged, so far decent, and still by no means sure to prevail. Give him a chance.

The presidential election

America not quite at its best

Sep 18th 2008
From The Economist print edition

The election has taken a nasty turn. This is mainly the Republicans' fault

Reuters



AS RECENTLY as a few months ago, it seemed possible to hope that this year's presidential election would be a civilised affair. Barack Obama and John McCain both represent much that is best about their respective parties. Mr Obama is intelligent, inspiring and appears by instinct to be a consensus-seeking pragmatist. John McCain has always stood for limited, principled government, and has distanced himself throughout his career from the religious ideologues that have warped Republicanism. An intelligent debate about issues of the utmost importance—how America should rebuild its standing in the world, how more Americans could share in the proceeds of growth—seemed an attainable proposition.

It doesn't seem so now. In the past two weeks, while banks have tottered and markets reeled, the contending Democrats and Republicans have squabbled and lied rather than debated. Mr McCain's team has been nastier, accusing Mr Obama of sexism for calling the Republican vice-presidential candidate a pig, when he clearly did no such thing. Much nastier has been the assertion that Mr Obama once backed a bill that would give kindergarten children comprehensive sex education. Again, this was a distortion: the bill Mr Obama backed provided for age-appropriate sex education, and was intended to protect children from sex offenders.

These kinds of slurs seem much more personal, and therefore unpleasant, than the more routine distortions seen on both sides. Team McCain accuses Mr Obama of planning to raise taxes for middle-income Americans (in fact, the Democrat's plan raises them only for those earning more than $250,000); Mr Obama claims Mr McCain wants to fight in Iraq for 100 years (when the Republican merely agreed that he would gladly keep bases there for that long to help preserve the peace, as in Germany) and caricatures him far too readily as a Bush toady (when Mr McCain's record as an independent senator has been anything but that).

An issue of life and life

The decision to descend into tactics such as the kindergarten slur shows that America is back in the territory of the "culture wars", where the battle will be less about policy than about values and moral character. That is partly because Mr Obama's campaign, perhaps foolishly, chose to make such a big deal of the virtues of their candidate's character. Most people are more concerned about the alarming state of the economy than anything else; yet the Democrats spent far more time in Denver talking about Mr Obama's family than his economic policy. The Republicans leapt in, partly because they have a candidate with a still more heroic life story; partly because economics is not Mr McCain's strongest suit and his fiscal plan is pretty similar to Mr Bush's; but mostly because painting Mr Obama as an arrogant, elitist, east-coast liberal is an easy way of revving up the Republican Party's base and what Richard Nixon called

the “silent majority” (see article).

The decision to play this election, like that of 2004, as a fresh instalment of the culture wars is disappointing to those who thought Mr McCain was more principled than that. By choosing Sarah Palin as his running-mate he made a cynical tryst with a party base that he has never much liked and that has never much liked him. Mr McCain’s whole candidacy rests on his assertion that these are perilous times that require a strong and experienced commander-in-chief; but he has chosen, as the person who may be a 72-year-old heartbeat away from the presidency, someone who demonstrably knows very little about international affairs or the economy.

What Mrs Palin does do, as a committed pro-lifer, is to ensure that the evangelical wing of the Republican party will turn out in their multitudes. Mr McCain has thus placed abortion, the most divisive cultural issue in America, at the centre of his campaign. His defenders claim that it is too big an issue to be ignored, that he has always opposed abortion, that culture wars are an inevitable part of American elections, and that it was only when he appointed Mrs Palin that the American public started to listen to him. All this is true: but the old Mr McCain, who derided the religious right as “agents of intolerance”, would not have stooped to that.




Resources

Economies of scales

Sep 18th 2008
From The Economist print edition

A new way of saving fisheries shows it can work; it deserves more attention

Alamy



Get article background

BEFORE 1995 the annual fishing season for Alaskan halibut lasted all of three days. Whatever the weather, come hell or—literally—high water, fishermen would be out on those few days trying to catch as much halibut as they could. Those that were lucky enough to make it home alive, or without serious injury, found that the price of halibut had collapsed because the market was flooded.

Like most other fisheries in the world, Alaska's halibut fishery was overexploited—despite the efforts of managers. Across the oceans, fishermen are caught up in a "race to fish" their quotas, a race that has had tragic, and environmentally disastrous, consequences over many decades. But in 1995 Alaska's halibut fishermen decided to privatise their fishery by dividing up the annual quota into "catch shares" that were owned, in perpetuity, by each fisherman. It changed everything.

Bream of sunlight

Despite their salty independence, even fishermen respond to market incentives. In the halibut fishery the change in incentives that came from ownership led to a dramatic shift in behaviour. Today the halibut season lasts eight months and fishermen can make more by landing fish when the price is high. Where mariners' only thought was once to catch fish before the next man, they now want to catch fewer fish than they are allowed to—because conservation increases the value of the fishery and their share in it. The combined value of their quota has increased by 67%, to $492m.

Sadly, most of the rest of the world's fisheries are still embroiled in a damaging race for fish that is robbing the seas of their wealth. Overfished populations are small, and so they yield a small catch or even go extinct. Yet the powerful logic in favour of market-based mechanisms has been ignored, partly because the evidence has largely been anecdotal. Now a study of the world's 121 fisheries managed by individual transferable quotas (ITQs), one form of market-based mechanism, has shown that they are dramatically healthier than the rest of the world's fisheries (see article). The ITQ system halves the chance of a fishery collapsing.

By giving fishermen a long-term interest in the health of the fishery, ITQs have transformed fishermen from rapacious predators into stewards and policemen of the resource. The tragedy of the commons is resolved when individuals own a defined (and guaranteed) share of a resource, a share that they can trade. This means that they can increase the amount of fish they catch not by using brute strength and fishing effort, but by buying additional shares or improving the fishery's health and hence increasing its

overall size.

There are plenty of practical difficulties to overcome. In theory, for instance, you should allocate shares through auctions. But if fishermen do not agree to a new system, it will not work. So fishermen are typically just given their shares—which can lead to bitter, politicised arguments. In Australia, a pioneer in ITQs, a breakthrough came when independent allocation panels were set up to advise the fishing agencies, chaired by retired judges advised by fishing experts. The next test will come in November, when two large American Pacific fisheries decide whether to accept market management.

ITQs, and other market mechanisms, are not a replacement for government regulation—indeed they must work within a well regulated system. And they will not work everywhere. Attempts to use ITQs in international waters have failed, because it is too easy for cheats to take fish and weaker regulations mean there are no on-board observers to keep boats honest. And ITQs will not work in slow-growing fisheries, where fishermen may make more money by fishing the stock to extinction than they ever would by waiting for the fish to mature. But in most of the world's fisheries, market mechanisms would create richer fishermen and more fish.

There was a time when fishermen were seen as the last hunter-gatherers—pitting their wits against the elements by pursuing their quarry on the last frontier on Earth. Those days are gone. Every corner of the ocean has been scoured using high technology developed for waging wars on land. Politicians and governments still seek to cope with fishermen's poverty by subsidising their boats or their fuel—which only accelerates the decline. Instead governments should promote property-rights-based fisheries. If fishermen know what's good for them—and their fish—they will jump on board.



On the London Stock Exchange, America's estate tax, poverty, Sarah Palin, remote tribes, quotes

Sep 18th 2008
From The Economist print edition

The London Stock Exchange

SIR – Your bald assertion that the merger last year of the London Stock Exchange and Borsa Italiana "has proved a disaster" is simply baseless ("Defying augury", September 6th). For one thing, I am hard pressed to think of any merger, certainly between two exchanges, that could genuinely claim to have "proved" itself within less than a year of completion.

More to the point, in the case of the merger between the LSE and Borsa Italiana, the key indicators augur well: we are making good progress on the integration and will shortly begin the migration of Italian equities onto the same trading platform as London. We also remain on track to deliver at least as much by way of revenue and cost synergies as we set out when announcing the transaction. In addition, the long-term potential of the Italian equity market remains exceptionally strong, as the fourth-largest economy in Europe continues to develop its equity culture from a very low base.

John Wallace
Director of corporate communications
London Stock Exchange Group
London

Mr Obama and the estate tax

SIR – I wrote a letter that you published about the estate tax in America (Letters, September 13th). I was inaccurate when I stated that Barack Obama wanted the exemption from the estate tax to fall back to its previous level of $1m. The exemption is due next year to increase from $2m to $3.5m; under current law it would revert to $1m in a few years' time. I believe my main point remains valid. Even with a higher exemption, many landholders would still be forced to sell potential conservation lands that might then face environmentally damaging development.

Blake Hudson
Environmental lawyer
Baker Botts
Houston

Counting the poor

SIR – You suggested that the World Bank's count of the number of people in poverty might fall back under 1 billion in the future if only we were to "track the prices the poor actually pay" ("The bottom 1.4 billion", August 30th). This is questionable. First, the international poverty line would also change with the new prices; it is unclear that the poverty count would in fact fall. Second, even if it does, it would probably be because the poor are forced to consume low-quality goods, which hardly makes them less poor. And third, by tracking the "prices the poor actually pay" in each country, one may end up using lower- quality goods in poorer places, which (as the bank's research has shown) leads one to underestimate the extent of poverty in the world.

Martin Ravallion
Director of research
World Bank
Washington, DC

Perspectives on Mrs Palin

SIR – Lexington (September 6th) lapsed into the same mode of thinking that exists in the powdered-wig political salons and among the media twitterati in his assessment of Sarah Palin, which stopped him from understanding why she strikes a chord with America's heartland. Mrs Palin connects with voters because she is one of us, not some elite politician entrenched in Washington's ways. John McCain had a problem with energising the Republican base, hence his choice of Mrs Palin. I, along with many other Republicans, was prepared to sit this contest out had he chosen either Joe Lieberman or Tom Ridge.

Sue Crane
Johns Creek, Georgia

SIR – If you believe that Mrs Palin has no experience, despite having been a local councillor, mayor, head of the Alaska Oil and Gas Conservation Commission and now governor, then you should at least have pointed out that Barack Obama hasn't sponsored any meaningful legislation and his attendance in the Senate is poor. And he is running for president.

Adam Gimbel
New York

SIR – Alaska is very different from the rest of the United States, and this difference affects the fitness of Mrs Palin to be vice-president. Fundamentally, Alaska is a pre-modern welfare state, where the economy is almost purely extractive (with the exception of defence and tourism). If you don't kill it, dig it or cut it down you don't get it. From that perspective "bridges to nowhere" are simply further extractions, or tokens for transfer payments from the rest of us, as are the annual payments to residents from North Slope oil revenues.

Not surprisingly Alaska is largely an innovation-free zone. It is also the only world that Mrs Palin has known. Along with her chronological and career inexperience this background renders her unprepared to lead the country.

Michael Golay
Professor of nuclear science and engineering
Massachusetts Institute of Technology
Cambridge, Massachusetts

SIR – Lexington used the fact that Mrs Palin is the first woman to appear on a Republican presidential ticket as evidence for "the triumph of feminism" (September 13th). Mrs Palin is the kind of female politician that only a certain kind of redneck, red-state, red-meat guy could vote for. She is the ultimate anti-feminist icon.

Hillary Clinton has substance, and look how far that got her. OK, she had baggage, and ran a hubristic campaign, but the sexist attacks she was subjected to nevertheless showed how far women in America still have to go. Any Hillary supporters likely to vote for Mr McCain because he chose Mrs Palin (I bet in real life there are three) are the kind of people who cut off their legs to spite their feet.

Laura Mosedale
London

Tribes in the Amazon

SIR – The development of oil and gas reserves on land inhabited by Amazon Indians is actually quite catastrophic for those you describe as living in "voluntary isolation", ie, without contact with the rest of the world ("Tread softly", August 30th). A tragic but little-known fact is that, historically, contact with these isolated groups has often resulted in the deaths of between 50-100% of their populations.

International law recognises these tribes as the owners of their land and they have not, as is required under that law, given their free, prior and informed consent for any oil or gas project to take place. So this is not about "treading softly"—people just should not go there in the first place.

Stephen Corry
Director Survival International
London

Heard it all before

SIR – I noticed the quote attributed to Ronald Reagan that introduced your leader on the economic situation ("How bad is it?", September 6th). Reagan is held to have said that "the nine most terrifying words in the English language are: 'I'm from the government and I'm here to help.'"

I remember a quip attributed to Denis Healey, a combative British chancellor in the 1970s. He said there are three things in life you should never believe: yes, I will still love you in the morning; the cheque is in the post; and hello, I'm a politician and I'm here to help. Perhaps this proves the adage that nothing has been said that was not said previously by somebody else who themselves did not say it first.

John Shepperd
London

Economist.com BRIEFINGS

British politics

Who killed New Labour?

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Jupiter Images



The death throes of Britain's ruling party suggest several possible culprits

Gordon Brown

"WE MEET in a spirit of hope," the new leader of the Labour Party told its annual conference. "For the first time in a generation", he declaimed, "it is the right wing that appears lost and disillusioned." The speech ended with an incantation: "New Labour! New Britain! New Labour! New Britain!"

That was Tony Blair, in 1994. It was a speech that announced the birth of New Labour—the flexible social-democratic movement that dominated British politics until very recently. Next week, at this year's party conference, Gordon Brown—Mr Blair's successor as Labour leader and prime minister—will also give a speech, conceivably his last big address in those offices. This one may come to be regarded as New Labour's elegy.

New Labour is dying. It has lost the three vital qualities that kept it alive and vibrant. First, discipline. A shared purpose and scowling party apparatchiks once bound Labour MPs to a party line; now some are calling for Mr Brown to stand down—and he may yet have to, little more than a year after he moved into Number 10. The rumblings about his leadership already constitute a crisis, and a humiliation, for him and his party.

Second, intellectual confidence: the party that once defined the intellectual terrain of politics has been reduced to aping its opponents' policies. Most important, New Labour has lost the habit of winning.

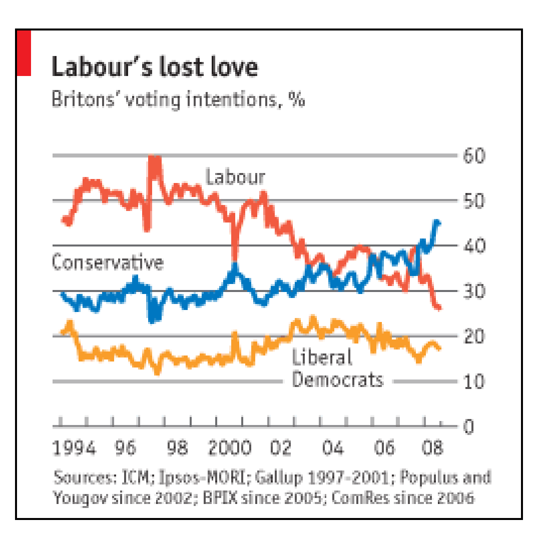
What has been one of the great election-winning forces in British political history has been routed in a run of parliamentary by-elections and local votes. Its poll ratings are so bad—a survey released on September 18th gave the Conservatives a 28-point lead—that recovery before the next general election, due by June 2010, looks almost impossible. On current form, the resulting defeat may be Labour's worst since the second world war. In the aftermath of such a rout, some Labour supporters fear, the party may disintegrate, with a revived Old Labour faction, wedded to the ideals of punitive taxation and a monolithic state, reasserting its anachronistic grip.

Mr Brown, in the library

But if the demise is plain enough, the explanation is less so. Who killed New Labour? There are three possible solutions: murder, natural causes or political suicide.

For some Labour MPs, the culprit is obvious: Mr Brown. He waited most of his life to fill the top job, scheming and manoeuvring during his long years as chancellor of the exchequer, destabilising the government with his simmering ambition and rows with Mr Blair. In June 2007 he finally got his wish—and botched it. Under Mr Brown's leadership, the party has haemorrhaged support and credibility. Unlike John Major—who also took over in mid-term from a long-serving and iconic predecessor, but whom the public mostly viewed as the decent if hapless leader of a disreputable rabble—this prime minister is even more unpopular than his party.

Mr Brown's fingerprints are all over the two most damaging mistakes of his brief premiership. First, the calamitous episode last autumn, when he floated the idea of calling a general election, then pulled back. It was a tragicomedy in three acts: by vacillating and then "bottling" it, Mr Brown ruined his claim to strong leadership; by claiming that alarming opinion-poll results had not swayed his decision, he undermined his trustworthiness; by meekly and hastily emulating a popular Tory idea on reducing inheritance tax, he seemed plagiaristic and desperate.



The other main debacle concerned the abolition of the 10% income-tax band, a change Mr Brown announced in 2007 in the last budget he delivered as chancellor. When it came into effect in April, several million low-income households were disadvantaged; the resulting furore eventually led to an emergency tax cut. And worse than both these cock-ups has been Mr Brown's personal and consistent failure to speak to the electorate in a language it understands—in other words, to discharge the key communications responsibility borne by all 21st-century democratic politicians. In place of vision and placating empathy, he seems to offer only droning iterations.

And if Mr Brown is the culprit, the remedy is plain: to get rid of him. That is the aim of the dozen or so Labour MPs—a couple of junior officials (promptly sacked), a gaggle of former ministers and a gang of backbenchers—who have publicly tried, but so far failed, to force a party-leadership contest. Their stand has been touchingly unco-ordinated; more effective, it may transpire, for seeming heartfelt rather than conspiratorial. Their aim is to pressure members of the cabinet to push Mr Brown out, using the threat of group resignations if he refuses. Ousting him would make Labour look chaotic, fractious and undemocratic. But the rebels calculate that short-term embarrassment is preferable to electoral obliteration.

On September 16th David Cairns, a minister in the Scottish office, resigned, citing doubts about Mr Brown's leadership. There are many others in government who sympathise (and some with scores to settle from the decade-long hostilities between Mr Brown's acolytes and Mr Blair's). For the moment, however, the insurgents lack a high-profile champion. They also lack an agreed successor. David Miliband, the clever young foreign secretary and a supposed candidate, professes his loyalty. Ditto two of his plausible rivals, Alan Johnson, the personable health secretary, and Jack Straw, the wily justice secretary.

Quietly in its bed

That may change if the rebellion mounts at or soon after next week's conference; some members of the cabinet have been less than full-throated in their support of Mr Brown. But if they think deposing him will revive New Labour at a regicidal stroke, the rebels are mistaken. New Labour is also suffering from a separate and incurable condition: old age.

Before 1997, no Labour government had served two full parliamentary terms in office. New Labour has managed three, winning two landslide victories in the general elections of 1997 and 2001 and a comfortable parliamentary majority in 2005. It has outlived the other governments of the centre-left that were once its peers—in France, Germany, America and elsewhere. But it has not—could not—defy political gravity indefinitely. It had to fall in the end.

Look at the evidence closely and it is clear that the decline precedes Mr Brown's move to Number 10. Between 1997 and 2005 the party lost 4m voters. It won its last general election with just 35.2% of the

popular vote, the lowest winning share ever. The grand coalition of working- and middle-class voters that swept Mr Blair to power in 1997—enabling him, with hubris but some justification, to describe his party as "the political wing of the British people"—has crumbled. Disappointments have mounted, as they must; the public craves new faces; antagonism to the Tories has faded. New Labour understands that natural process, which is partly why it replaced Mr Blair, just as the Tories confected an impression of change by installing Mr Major in place of Margaret Thatcher.

Yet change and attrition in personnel—a natural consequence of the government's longevity—has weakened New Labour too. Several of its most talented and determined campaigners—some of the people who created New Labour—have, one way or another, departed. Peter Mandelson and David Blunkett were obliged to leave the government twice each. Robin Cook resigned over Iraq. Jaundiced as his relationship with the country became (not least because of Iraq), Mr Blair was by light years the party's biggest star.

The other natural cause that has caught up with New Labour is the economic cycle—exacerbated and accelerated, in this case, by the credit crunch and rises in commodities prices. Inflation in Britain has crept up and growth stalled; recession, albeit perhaps a short one, is imminent if not already happening. The hardship may so far be mild compared with previous downturns in the 1970s and 1980s. But those are now distant memories, and for young voters scarcely a memory at all.

For a prime minister who built his reputation, and his claim to the premiership, on economic management, the political consequences are especially acute. When he was chancellor, Mr Brown claimed, rashly and repeatedly, to have led Britain out of the old pattern of "boom and bust". He sucked up credit for economic success, for which New Labour was only marginally responsible. He ought not to be surprised that the public blames him now.

Among some Labour MPs, these twin conditions—a sense of superannuation, and the gathering economic gloom—have induced a kind of fatalism: a belief that, disappointing as Mr Brown may be, no other leader could resist the forces that are driving Labour to defeat. This despair may constitute the prime minister's best hope of avoiding a coup. And in their way these implacable but impersonal elements offer a consoling explanation of Labour's woes, especially for Mr Brown himself.

PA



Bushy-tailed Blair and Brown in 1994

By its own hand

But they are not the whole solution of the New Labour mystery either. It is true that time kills all governments and that economic troubles often make them unpopular. But the Tories won an election during a downturn in 1992. And it was not inevitable that three parliamentary terms would be New Labour's limit (Mr Blair used to talk about bequeathing a "progressive century"). There is another factor, one which few Labour MPs wish to confront.

"It is not this or that minister that is to blame," Mr Blair said of the Tories in that 1994 speech: it was, he said, a whole ideology that had failed. Something similar might be said of New Labour today. Its approach to government increasingly looks expensive, exhausted and outmoded.

New Labour emerged in the 1990s from a double epiphany on the part of Mr Blair, Mr Brown and others: an intellectual acknowledgment that deregulation and free markets were, after all, the best way to maximise prosperity; and a political recognition that, with the shrinkage of its traditional working-class base, Labour would never win power again unless it courted and reassured the middle classes.

These realisations were honed—partly in wonkathons with Bill Clinton and other New Democrats—into a rough-and-ready political philosophy. It purported to offer a new path between socialism and neoliberalism, promising a utopia of "ands": competitive tax rates and quality public services, which would be blessed with both investment and reform; patriotism and internationalism (as Mr Blair wrote in a 1998 pamphlet on the "third way") and rights and responsibilities; tough on crime and tough on the causes of crime; a free market and a robust social safety net; have cake and eat it. The Old Labour fixation on equality of outcomes was replaced by a new notion of "equal worth". The state was to be an "enabler" and guarantor. The poor would be "levelled up" rather than the rich squeezed down. Mr Blair famously did not have "a burning ambition…to make sure David Beckham earns less."

The rhetoric was excoriated by some as vapid marketing, and by others as thinly disguised neo-Thatcherism. But New Labour did, in fact, have corresponding policies. It demonstrated its commitment to macroeconomic stability by giving the Bank of England autonomy in the setting of interest rates; just as the New Democrats fetishised budget-balancing, so Mr Brown, as chancellor, bound government expenditure with his fiscal "golden rules" (which he now looks set to break). But there was also a minimum wage, assorted welfare-to-work schemes and covert redistribution of wealth through a fiddly system of tax credits. There was lots of cash for public services, combined, albeit belatedly, with some market-based reform; the introduction of tuition fees for universities; more freedom for some hospitals and schools; the encouragement of competition among providers, including private ones.

Cameron, the grave-robber

Many of these policies were initially opposed by the Conservatives, but most have now been adopted by David Cameron, their leader since 2005. Mr Cameron has also accepted New Labour's social liberalism, updating his party's official views on sexuality, and evinced (or simulated) a concern for the poor. New Labour has succeeded in making compassion compulsory. And Mr Cameron has embraced New Labour's public-service reform agenda—while indicating that Britain's universal, tax-funded health service will remain politically sacrosanct under a Tory government. Just as New Labour swallowed deregulation and free markets, so Mr Cameron has incorporated many of New Labour's central tenets. He, too, has helped to kill New Labour—but also, arguably, to ensure some of its ideas endure, reincarnated as Tory policy.

Unfortunately, for the party and the country, New Labour was also undermined from its inception by internal weaknesses and contradictions. These have always been visible, but now look terminal.

One of the problems is that having and eating the cake is possible only if the cake is big enough. New Labour spent lavishly on the public services, at first as a substitute for proper reform and then as lubrication for it. With the economy growing steadily, healthy government receipts paid for the generous benefits and tax credits. Now, perforce, the splurge is over—and tougher times require choices that New Labour hoped, and for a long time managed, to avoid. It has come to look rather like a fair-weather creed.

The pressure on the budget has also revealed fissures within the Labour Party, cracks that have opened periodically but are now gaping. New Labour, like most political parties, has always been a precarious coalition of parliamentarians and interests, from trade unionists who submitted to the "third way" reluctantly, to sharp-suited "modernisers". Economic hardship and tightening spending constraints have brought the resulting tensions into the open: witness the recent row over whether the government should impose a windfall tax on energy companies and use the money to help poor families meet their rising fuel bills (it didn't).

Those disagreements may also help to save Mr Brown, since his critics have no coherent view on the changes that ought to follow. It isn't only the money that has run out. So have the ideas.

Although he was one of New Labour's architects, as chancellor Mr Brown cultivated a reputation as less New and more straightforwardly Labour than Mr Blair, perhaps because this stance strengthened his hand in internal party politics. As prime minister, he at first seemed unenthusiastic about Mr Blair's efforts to inject choice and competition into the public services. But he has recently seemed more committed, appreciating, perhaps, that simply pledging improvements, without a credible theory of how they might be achieved, wouldn't wash. In fact, many of his biggest troubles as prime minister have derived from an excess of New Labour orthodoxy. His government's indecision over how to handle the collapse of Northern Rock, the bank that was an early victim of the credit crunch, was partly born of a violent allergy to the term "nationalisation", with its whiff of Old Labour shibboleths. His quixotic determination to enact illiberal anti-terror laws reflects a deep New Labour conviction that it must never be out-toughed on crime and security.

A thousand cuts

All the same, the intellectual momentum that gathered under Mr Blair has dissipated. Mr Brown may not have unravelled existing policies, but there is little sign of a new phase of reform: in primary schools, for example, or in the powers and structure of local government. New Labour's push to decentralise power and decision-making—to create a new kind of state—has always been retarded by a countervailing instinct, one that combines the retentive neurosis that British governments of all stripes have shared with a residual old-fashioned statism. The haphazard effort now seems to have stalled.

Finally, during New Labour's long spell in office, the world has changed. The new worries of terrorism and immigration favour parties of the right across Europe. New Labour, meanwhile, has yet to hit upon a distinct and persuasive approach to the new, strategic problem of climate change or the more immediate one of mayhem in the global economy. A deficit of imagination is a problem for any administration, but a crippling one for governments of the centre-left, which tend to live and die by their ideas.

"Their time is up." Mr Blair said of the Tories in 1994: "Their philosophy is done. Their experiment is over." New Labour seems, at the moment, to have reached that point too. Old age, penury, Mr Cameron, Mr Brown: they are all incriminated. But, in the end, New Labour killed itself.

The financial crisis and the election

The politics of despair

Sep 18th 2008 | WASHINGTON, DC
From The Economist print edition

Wall Street's meltdown readjusts the race in unexpected ways

AP



WITH an investment bank failing, an insurance giant needing a bail-out, the Dow tumbling and panic gripping Wall Street, Barack Obama spoke graciously about his opponent. "I certainly don't fault Senator [John] McCain for these problems," he said. He also refrained from blaming him for global warming and Hurricane Ike. But he did fault Mr McCain for his economic philosophy, "a philosophy that says even common-sense regulations are unnecessary and unwise, and one that says we should just stick our heads in the sand and ignore economic problems until they spiral into crises."

Both candidates doubtless wish to tackle the crisis. But they cannot, since neither will be in charge until January and the crisis must be tackled immediately. So each is trying to sound as if he would knock some sense into Wall Street, while tut-tutting that the other fellow supported the policies that got America into this mess in the first place.

Mr Obama has the immense advantage that voters tend to blame the party in the White House for bad news. His campaign has looked sickly in the past few weeks, since Mr McCain picked Alaska's Governor Sarah Palin as his running-mate and then surged ahead in the polls. As the American financial system stumbles, however, Mr Obama is catching up. A poll of polls by RealClearPolitics.com, a political website, now puts Mr McCain less than a percentage point ahead.

Mr Obama contends that the nightmare on Wall Street was caused by financial deregulation of the sort Mr McCain has long championed. This is partly true. Lax oversight did indeed allow financial firms to borrow far more than was prudent to make bets that have now gone sour. Tougher regulations might have prevented this. Mr Obama reminded voters in Colorado on September 16th that Mr McCain recently said: "I'm always for less regulation." Now the Republican candidate says he favours stricter regulations, though he provides few details.

The Obama campaign also contends that Mr McCain is so rich (his wife is worth an estimated $100m) that he does not understand the woes of cash-strapped ordinary Americans. Mr McCain does not help his case by saying things like "the fundamentals of our economy are strong". That may be true, depending on how you define "fundamentals", but it does not sound empathetic. Joe Biden, Mr Obama's running-mate, scoffed that "I could walk from here [St Clair Shores, Michigan] to Lansing [about 94 miles, or 151km], and I wouldn't run into a single person who thought our economy was doing well, unless I ran into John McCain."

Mr Obama insinuates that Mr McCain cannot be trusted to deal with the crisis because his strings are pulled by lobbyists, who “shred consumer protections and distort our economy so it works for the special interests”. Or, as Mr Biden put it: “The very few wealthy and powerful have a seat at the table and everybody else is on the menu.” It is true that the financial, insurance and real-estate industries have donated $22m to Mr McCain’s campaign. But they have given $25m to Mr Obama.

Finally, the Obama campaign suggests that the 72-year-old Mr McCain is too doddery to understand the doohickeys that modern bankers (and others) use. A campaign ad says he “doesn’t know how to use a computer, can’t send an e-mail”. Mr McCain admits that he gets others to call up websites for him. One reason is that the injuries he sustained as a prisoner of war make it painful for him to type.

Mr McCain’s first response to the crisis was to rage about the “reckless conduct, corruption and unbridled greed” that he says caused it. He fumed that when financial firms collapse, only the bosses seem to escape the consequences. Under a McCain presidency, he promised, “we’re not going to tolerate that any more.”

Mr Obama said that no one should trust Mr McCain’s promise to establish proper oversight of Wall Street because “he has shown time and again that he does not believe in it”. The truth is more confusing. Mr McCain’s instinct to give markets free rein has always tussled with his Teddy Roosevelt-like suspicion of over-mighty corporations. The confusion is compounded by his obvious lack of interest in, or knowledge of, the nuts and bolts of finance. His main concrete proposal this week was to set up a commission to study what caused the current crisis and recommend reforms to prevent another one.

Mr Obama sounded more at ease as he reiterated the principles by which he would regulate the American financial system. First, he said, any financial institution that can borrow from the government should be subject to stricter government oversight. Second, he would strengthen capital requirements and demand better disclosure of risks and obligations that firms hide off their balance sheets.

Third, he would streamline regulatory agencies. Fourth, he would regulate institutions for what they do, not what they are. For example, mortgages should be subject to the same rules whether offered by a bank or a mortgage-broker. Fifth, he would crack down on market manipulation. And sixth, he would establish a process to identify systemic risks before they explode.

Mr McCain’s strongest point this week was one he made only briefly, when he drew attention to the other big factor behind the meltdown: the two government-sponsored mortgage giants, Fannie Mae and Freddie Mac. These two firms own or guarantee about half the home loans in America. Until they almost collapsed and had to be (mostly) taken over by the government earlier this month, they were a ghastly hybrid. The government implicitly guaranteed their creditworthiness, enabling them to borrow at below-market rates. But private shareholders pocketed the profits they made lending this cheap money at higher interest rates.

Fannie and Freddie were supposed to make it easier for creditworthy borrowers to buy homes. But most of the implicit subsidy went to shareholders. And since managers knew they could rely on the government to bail them out, they expanded recklessly, contributing to the property bubble that has now burst. The cost of Fannie’s and Freddie’s bail-out, which could be huge, will be borne by taxpayers. The blame rests with Democrats and Republicans in Congress, who encouraged Fanny and Freddie to keep growing, not least because the firms lobbied them so lavishly.

Both Mr McCain and Mr Obama said some time ago that trouble was brewing, but they offer different solutions. Mr McCain argues that both institutions should eventually be disbanded. Mr Obama thinks they can be reformed, and wants to go on pumping public money into the housing market. Mr McCain notes that Mr Obama took more donations from Fannie and Freddie than any politician bar the chairman of the committee they answer to. “That’s not change,” he said. “That’s what’s broken in Washington.”

The election campaign

Heard on the stump

Sep 18th 2008
From The Economist print edition

The eye of the beholder

"I left his eyes red and his skin looking bad."

Jill Greenberg, a celebrity photographer and Democrat, deliberately took a series of unflattering shots of John McCain for the cover of the Atlantic *magazine. The magazine was unaware of her intentions.* New York Post, *September 14th*

I ♥ Hillary

"Hillary Clinton is as qualified or more qualified than I am to be vice-president of the United States of America... and quite frankly, it might have been a better pick than me."

Joe Biden on Hillary Clinton, Associated Press, September 10th

I ♥ Hillary more

"I think he's regretting not picking her now, I do. What, what determination, and grit, and even grace..."

Sarah Palin on Hillary Clinton, ABC News, September 12th

Blessed are the poor

Illustration by KAL



"I make a good salary, although I am listed as the second-poorest man in this Congress. I'm not proud of it...But that's what happens when you get elected when you're 29 years old."

Mr Biden released his tax returns, revealing that he and his wife have had an average annual income of $245,000 over the past ten years. CNN.com, September 12th

Snake oil

"If you think those lobbyists are working day and night for John McCain just to put themselves out of business, well then I've got a bridge to sell you up in Alaska."

Barack Obama challenges Mr McCain's change credentials. Politico.com, September 15th



Raising the bar

"Sarah knows how to field-dress a moose. I know how to castrate a calf."

Patty Judge, lieutenant-governor of Iowa, touts her skills. IowaPolitics.com, September 15th

Blunt-force trauma

"Well, I don't think John McCain could run a major corporation."

Carly Fiorina, former head of Hewlett-Packard and economic adviser to Mr McCain, who added that no other candidate could run a big corporation either. MSNBC, *September 16th*

I am Spartacus

"Now, the American public itself almost demands there be a kind of gladiatorial element. They want Obama to go in there and gut McCain...They want to see him smite his opponent in the election with a real muscularity."

Alec Baldwin's advice to Mr Obama. New Republic, *September 16th*

Hurricane Ike

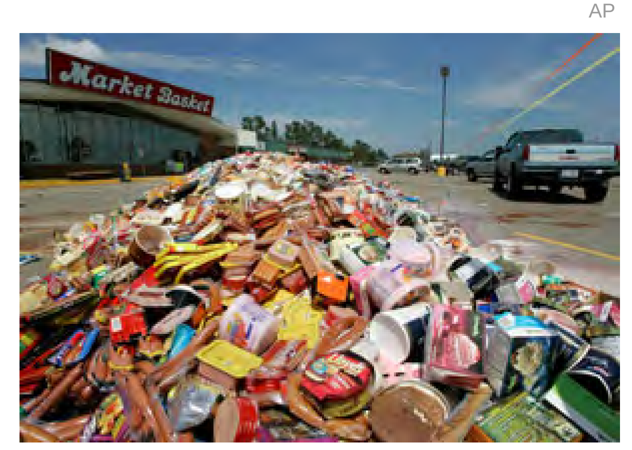
Please send ice

Sep 18th 2008 | HOUSTON
From The Economist print edition

The Gulf coast of Texas is slowly picking up after another hurricane

IT WAS a beautiful, breezy afternoon, and Jeff and Lisa Frechette were determined to enjoy it. Granted, they were sitting on a patch of grass beside a petrol station, in the shadow of a jammed freeway. They had been sleeping in their car for several days, after evacuating Galveston Island as a hurricane hurtled straight towards them. For that matter, they had barely been settled in Galveston; the couple moved to Texas after Mr Frechette was laid off from his job at a Ford plant in Minneapolis. Still, things could have been worse.

AP



What's left behind

"Actually, you know, we're getting used to it," said Mr Frechette. A pair of cockatiels whistled quietly in a cage beside them. A man from Abilene had just given them a tent. There was a makeshift shower rigged up on the other side of the building. The night before someone came by with a propane grill and cooked brisket for everyone. They did not miss Minnesota. "We've had a lot of stuff happen there, too," said Linda.

On September 11th the National Weather Service issued a grim warning about Hurricane Ike, which was barrelling through the Caribbean on its way to Galveston, a barrier island off the Gulf coast of Texas: "Persons not heeding evacuation orders in single-family one- or two-storey homes will face certain death." It would probably arrive in Galveston as a Category 3 colossus, the size of Texas. Water would surge 25 feet, washing over the sea wall and devastating the island. Then it would carry on to Houston, 70 miles (112km) inland, the fourth-largest city in the country.

At this prospect, mandatory evacuation orders were issued for almost 1m people in Galveston and the coastal cities. Millions more, in Houston, were asked to stay put. Ed Emmett, the Harris County judge, explained that they would lose power but not their lives—and they had to keep the roads clear for the people in grave danger. The last time a major hurricane menaced the Texas coast, in 2005, everyone tried to leave at once. Chaos ensued, and about 100 people died during the evacuation.

The focused evacuation worked out better. Like Hurricane Gustav, which made landfall in Louisiana earlier this month, Ike could have been a lot worse. It tacked a bit north-west and hit Galveston Island in the early hours of September 13th as a category 2, with winds of 110 miles an hour. Its surge, at around 13 feet, was not high enough to destroy the sea wall.

But Ike's damage was severe, and it will take weeks fully to assess its impact. So far 30 deaths have been reported in Texas, but officials worry that the toll will mount as the waters recede and rescue operations continue. (There were also several dozen fatalities outside Texas; Ike caused flooding from

Louisiana to Illinois, knocked out power in swathes of Ohio, and spun off tornadoes in Arkansas.)

Houstonians went through a frightening night, with winds howling, trees falling and windows breaking. The next morning more than 2m homes were without power. In the days after the storm, the Federal Emergency Management Association (FEMA) opened dozens of distribution centres around the area to hand out ice, water and food. Schools were closed, as were most businesses.

The mayor, Bill White, announced a citywide curfew. At mid-week police had arrested about 100 people for looting. Authorities were on the watch for price gouging. Nerves were starting to fray. Some people were frustrated by the long queues and short supplies at the FEMA stations. Others seethed about the power shortages. But, all things considered, Houston was holding up quite well.

Credit should go to city officials like Mr White and Mr Emmett, who exuded competence and calm. On September 16th, three days after the storm, Mr White announced that they would take over distribution efforts from FEMA. George Bush had been in Texas that day, promising federal help. But Mr White was frustrated by the logistical snafus. Two hundred trucks full of supplies had sat in a downtown parking lot all day. Meanwhile, people at some distribution spots had waited for hours before being turned away empty-handed. “We’re taking matters into our own hands,” said Mr White.

It also helped that the people of Houston were in full neighbour mode. A local radio station fielded a steady stream of tips—free bananas and water at one Wal-Mart, several ice trucks pulling up to one of the FEMA stations, a petrol station with no queues. And Houstonians were grateful for the help. “It’s a blessing here,” said Ronald Jackson, who took his son to a city shelter because their house had no power and their food was spoiled. “I wouldn’t mind staying. Keep my bills down.” It could take a month to restore power to everyone. But Houston, which marshalled vast resources to aid evacuees from Hurricane Katrina in 2005, is well qualified to help itself.

The situation in Galveston and the adjacent Bolivar peninsular is more serious. Despite the “certain death” warnings, perhaps 20,000 people rode out the storm on the island. After it, an undetermined number had not been contacted. There was no power or water. Hundreds of structures were destroyed, including a memorial to the victims of a 1900 hurricane that killed 8,000 people. A lion was holed up in a Baptist church and a tiger had escaped to Crystal Beach. The mayor, Lyda Ann Thomas, warned that it was an unhealthy environment and asked people to leave.

Meanwhile, those who had evacuated Galveston were in limbo, having been kept off the island for days. On the busy Tuesday in question, Ms Thomas announced a “Look and Leave” programme. Islanders could return with proof of residence to assess the damage to their homes.

And so at the petrol station in La Marque, a few miles from the coast, weary travellers came to join people like the Frechettes. Anne McCarty explained that when she heard about Look and Leave, she thought she would try to find out what had become of her apartment in Galveston. But the traffic was too bad, and the rumours worrying. One story, relayed by customers at a doughnut shop, was that a helicopter survey of Galveston Island had revealed bodies in the water and alligators in the streets.

Ballot initiatives

Goading the enemy

Sep 18th 2008 | LOS ANGELES
From The Economist print edition

Some proposals will fall victim to their own outrageousness

ONE of the entertaining things about the American political system is the hearing it affords cranks and zealots. In about half of the states, many of them in the West, ordinary people can put measures on the ballot if they manage to gather enough signatures. This year about 60 have made the cut, while politicians have added another 70 or so. So on November 4th, the same day they choose the world's most powerful man, Californians will decide whether to grant more room to battery chickens. Residents of Missouri, 95% of whom speak English at home, will rule on whether to declare English the official state language.

Many of the measures are mundane, allowing governments to issue bonds or subtly tweaking state constitutions. Voters in Ohio, Maine and Maryland will be able to approve or block new casinos. But some measures aim dramatically to increase or curtail personal liberties. These can affect national campaigns.

Dope, eggs and abortion
Ballot initiatives

State	Proposition number	Action	Base-mobilising potential*
Arkansas	1	Bar unmarried couples from adopting children	elephant
California	8	End same-sex marriage	elephant elephant
Colorado	48	Classify fertilised eggs as people	donkey donkey
Florida	2	Ban future same-sex marriages	elephant elephant elephant
Massachusetts	2	Decriminalise petty marijuana use	donkey
South Dakota	11	Ban most abortions	elephant elephant

Source: *The Economist* — *Likely effect on state races

Four years ago some of John Kerry's supporters blamed ballot initiatives for his defeat. Measures banning gay marriage were put before voters in 11 states, and passed in every one. Even if they didn't raise turnout much—social conservatives were fired up everywhere—they coloured the race. The gay-marriage bans helped turn 2004 into a "values" election, which suited Republicans. In 2006 liberals fought back, putting minimum-wage increases on the ballot in six states. All passed, and Democrats took control of Congress.

This year something odd has happened. As in 2004, there are many more measures designed to appeal to conservatives than to liberals. Yet much of the red meat is unpalatable. The measures over-reach, open up new battles that conservatives would be ill-advised to fight, and pose more problems for Republican candidates than for Democrats. A few are so toxic that liberals might have written them.

Take, for example, Colorado's Amendment 48. Put on the ballot by a home-schooled Baptist woman, this would define a fertilised human egg as a person. The amendment would presumably turn not just abortion and embryonic stem-cell research into the equivalent of murder, but do the same for some kinds of birth control. The "egg-mendment", as critics dub it, is likely to mobilise moderate women voters in opposition while drawing attention to John McCain's and Sarah Palin's strict views on abortion—and this in a swing state. In November it will almost certainly go down in flames.

Or take Arkansas's Initiative One. This began as an effort to prevent gay couples from adopting children. But the Arkansas Family Council, a Christian conservative group, decided to broaden the ban to cover all cohabiting couples, gay or straight. It does not apply to single people, who are presumably less sinful. If, as supporters believe, this is a new avenue for evangelical campaigning, it is an utterly ruinous one. There are a lot more unmarried voters than gay voters, and opponents of such measures can simply

point to the crush of children awaiting adoption. The initiative has divided and embarrassed Republicans.

This year may also see at least one major setback for opponents of gay marriage. The most watched battle is in California, where same-sex marriages were upheld by the state Supreme Court in May. Even before the judgment came down, a conservative group had begun to collect signatures for a measure defining marriage as a union between a man and a woman. At first the measure looked almost certain to pass. Then Jerry Brown, California's liberal former governor and now its crafty attorney-general, rewrote the summary of the ballot measure. Voters are now informed that it would "eliminate the right of same-sex couples to marry". That makes a big difference. Polls suggest that Californians are keen to restrict marriage in the abstract, but much less keen on taking rights away from people who already have them.

Voters in Arizona and Florida will also weigh in on gay marriage. A ban will almost certainly pass in Arizona but not in Florida, where it must win 60% of the vote. Conservatives will campaign hard. Yet they face a dilemma. Blacks and, to a lesser extent, Hispanics tend to oppose gay marriage more strongly than whites do. If Florida's blacks turn out in force, it will not do John McCain much good.

Few measures will cause liberal hearts to beat faster, although a couple may mobilise the stoner vote. Michigan will decide whether to legalise marijuana for medicinal purposes. More radical is a ballot question in Massachusetts, which would make the possession of small amounts of dope a civil offence, punishable by nothing heavier than a $100 fine. Such measures are unlikely to tip the result. Given the havoc created by over-zealous conservatives, the Democrats shouldn't need much help.



Campaign donations

Writing cheques, hedging bets

Sep 18th 2008 | NEW YORK
From The Economist print edition

A surge in corporate money for the Democrats

AUGUST was the best money-spinning month so far for the presidential candidates. In that month both men beat their fund-raising records. John McCain's campaign, heartily boosted by Sarah Palin, brought in $47m; but Barack Obama raised $66m, more in a single month than any candidate for political office in America's history.

Mr Obama has helped to change the direction of corporate giving. By late July, the political action committees of American companies had contributed almost $214m to the Democrats and Republicans. For the first time in over two decades, the cash was evenly divided: each party received roughly $107m.

Traditionally Democrats have always lagged in attracting money from business. During the 1996 election cycle, for instance, Republicans received almost 73% of corporate donations while Democrats received 27%, according to the Federal Election Commission. This uneven ratio persisted almost up to the present. In the last presidential election, in 2004, Republicans received close to 68% of the money that businesses gave.

The new trend is not simply important for the war-chests of Democratic candidates. It also suggests that corporations are betting on a Democratic victory in November. The trend of giving to Democrats accelerated, and giving to Republicans declined, as soon as the Democrats won control of Congress in 2006. This year Democrats expect their congressional majorities to swell, and corporations may be positioning themselves for a long Democratic ascendancy.

But many corporations may also think that a Democrat will win the presidency, which could explain why corporate donations to the Democrats have risen so much. Darrell West, a vice-president of the Brookings Institution, a think-tank, says that because many corporations anticipate a victory for Mr Obama, they consider their gifts to Democrats an investment in their company's future. Among the top contributors are sectors with special interests, including banks, telecoms companies and the health-care industry.

Corporations were conspicuous at the Democratic convention, which boasted 141 business sponsors. According to the non-partisan Campaign Finance Institute, the Republican convention has announced only 91 sponsoring companies. The Republicans may not yet have disclosed all their sponsors; but nonetheless, so far, fat cats are contributing the Democrats' way.

Swing states: Virginia

Of pigs and polls

Sep 18th 2008 | LEBANON, VIRGINIA
From The Economist print edition

Barack Obama and John McCain are evenly matched in the Old Dominion

THE crowd in the school gym was ecstatic. Barack Obama won them over long before he even showed up. But the locals watching on television were a different matter. Lebanon is a small town in rural south-western Virginia. The folks round here are suspicious of big-city liberals. How would they respond to a smooth-talking Democrat from Chicago?

Mr Obama strolled in wearing a suit that looked as if it cost more than some of the cars parked outside. Sensing perhaps that he was overdressed, he took off his jacket and faced the crowd in his shirtsleeves. He reprised his usual themes: people are hurting, it's time for a change, I won't take away your guns and this campaign is not about me, it's about you.

Mindful of his audience, he salted his rhetoric with rustic metaphors. Explaining why schoolchildren should take fewer tests, he said: "You don't fatten a hog by weighing it." Riffing on his core message, that John McCain promises change but espouses Bush policies, he said: "You can put lipstick on a pig, [but] it's still a pig."

It was obvious what he meant. But suspicious minds caught an allusion to Sarah Palin's frequent mentions of lipstick and a four-legged creature. Within minutes, the canard spread that Mr Obama had called Mr McCain's running-mate a pig. Talk shows seized on it, and the McCain campaign squealed sexism.

Meanwhile, Virginia's 13 electoral votes (out of 270 needed to win) are up for grabs. Polls show Mr Obama and Mr McCain neck and neck. Although the state has not voted Democratic in a presidential race since 1964, it is trending purple.

State statistics

Population, 2006, %

Virginia | National average

0 10 20 30 40

Black
Hispanic
Under 25
Veterans*
Blue-collar workers
Unemployment rate

Virginia total, m 7.6

Household income§, 2006, $

Virginia	56,277
National average	48,451

Poll ratings, %
Average September 7th to 14th

0 5 10 15 20 25 30 35 40 45 50

Barack Obama
John McCain

Sources: Census Bureau; RealClearPolitics.com
*Of adult population †July 2008 ‡August 2008 §Median

The relentless expansion of the federal government has attracted legions of lawyers, lobbyists, contractors and bureaucrats to the suburbs of northern Virginia, whence many commute to Washington, DC. These newcomers, less conservative than rural Virginians, helped elect a Democratic governor, Tim Kaine, in 2005 and a Democratic senator, Jim Webb, in 2006.

Such is the importance of Virginia that both Mr Kaine and Mr Webb were seen as vice-presidential prospects. Mr Kaine, a competent but slightly dull fellow with big eyebrows, even made Mr Obama's shortlist. Another Virginia Democrat, a popular ex-governor and mobile-telephone tycoon called Mark Warner, considered running for the presidency, but dropped out when he realised that the party was determined to nominate either a woman or a black.

This year Mr Warner is running for a vacant Senate seat he is likely to win handsomely. Democrats hope he will give Mr Obama a big boost. But Larry Sabato, a politics professor at the University of Virginia, thinks that unlikely. On the ballot, voters pick a president first and a senator afterwards, he notes, so Mr Warner will probably help Mr Obama only slightly.

Both candidates visit Virginia often. Mr McCain attracts warm support from the state's many military families. He has a more ticklish history with the religious right in Virginia; this is where in 2000 he picked

a fight with the “agents of intolerance”, and they have not forgiven him. But they dislike Mr Obama more, not least because he opposes even mild curbs on abortion. And they love Mrs Palin, who campaigned with Mr McCain in Virginia last week, drawing a far keener crowd than Mr McCain usually does. Mr Obama, meanwhile, can rely on black Virginians—one-fifth of the population—and liberals.



The outcome will depend on three factors. First, can Mr McCain hold Mr Obama to a narrow victory in northern Virginia? Second, can he notch up big margins in rural areas and small towns? And third, how will race affect the vote?

Mr Obama is popular in northern Virginia, where people have been walloped by collapsing house prices and are eager for change. But Mr McCain will probably do better than George Bush there, because moderate suburbanites like his record on such issues as climate change and immigration. With Mrs Palin protecting his right flank, he is free to reach out to them.

In small towns like Lebanon, Mr Obama appeals to people’s economic grievances. High petrol prices hurt most where people have to drive the farthest to get anywhere. Debbie Gross, a retired furniture saleswoman, says she and many of her neighbours now grow their own vegetables to save money. “I think Barack Obama would put more control on the oil corporations. When that’s in place, everything else will fall into place,” she says.

But many rural Virginians find it hard to relate to a snappily-dressed former law lecturer with soft hands. Pictures of Mrs Palin posing with heavy machines and dead animals strike a deep cultural chord. “I like that gal,” says Floyd Keen, a Wal-Mart customer near Lebanon. “She’s more country than I am.”

And Mr Obama’s race is a wild card. Elizabeth Houston, a black Obamaphile, says whites fear that if he becomes president, “he’ll make them pay reparations for slavery.” But how many really believe that? Virginia, once the heartland of slavery, elected a black Democratic governor, Douglas Wilder, two decades ago. Granted, Mr Wilder was more conservative than Mr Obama, and worked hard to charm working-class whites. According to the *Weekly Standard*, a conservative magazine, he once said to striking miners: “[I heard you boys] would vote for a nigger before you’d vote for a Republican, and I’m here to tell you that this November, you’re gonna get your chance.”

Mr Wilder led by a wide margin in the polls but won by a whisker. Because racists lie to pollsters, Mr Obama is probably weaker in Virginia than he looks. But he is better organised than Mr McCain. And times change.



Lexington

Richard Milhous McCain

Sep 18th 2008
From The Economist print edition

Americans cannot escape from the shadow of Tricky Dick

Illustration by KAL



MODERN Republicans admire no one more than Ronald Reagan, the man who, in their view, destroyed communism, rolled back welfare-state liberalism and reintroduced God into American politics. But when it comes to practising politics, particularly at election time, the Republicans have a rather different hero, a man of frowns rather than smiles: Richard Nixon.

Nixon's great contribution to Republican politics was to master the politics of cultural resentment. Before him, populism belonged as much to the left as the right. William Jennings Bryan railed against the eastern elites who wanted to crucify common folk on a "cross of gold". Franklin Roosevelt dismissed Republicans as "economic royalists". Nixon's genius was to discover that the politics of culture could trump the politics of economics—and that populism could become a tool of the right.

Nixon understood in his marrow how middle-class Americans felt about the country's self-satisfied elites. The "silent majority" had been disoriented, throughout the 1960s, by the collapse of traditional moral values. And they had boiled with righteous anger at the liberal elites who extended infinite indulgence to bomb-throwing radicals while dismissing conservative views as evidence of racism and sexism. Nixon recognised that the Republicans stood to gain from "positive polarisation": dividing the electorate over values. He also recognised that the media, which had always made a great pretence of objectivity while embracing a liberal social agenda, could be turned into a Republican weapon. He encouraged Spiro Agnew, his vice-president, to declare war on the "effete corps of impudent snobs" in the media, with their Ivy League educations and Georgetown social values.

Many people predicted that 2008 would finally mark the end of the Nixon era. The issues were too grave to be swamped by a squabble about culture, the argument went. And the candidates, in the form of John McCain and Barack Obama, were too noble to be distracted by the siren voices of the culture war. George Packer dismissed the remains of the culture wars as "the spasms of nerve endings in an organism that's brain-dead". Andrew Sullivan hoped that Mr Obama might finally take America "past the debilitating, self-perpetuating family quarrel of the baby-boom generation that has long engulfed all of us". This paper saw the two candidates as "America at its best."

Not quite. Two weeks after the Republican convention, America seems to be hellbent on repeating the 1972 election. Forget about the "sunny uplands" of post-partisan politics. The American electorate is still trapped in Nixonland: a land where Democrats and Republicans exchange endless gibes about who

despises whom, where simmering class and regional resentments trump all other political considerations and where the airwaves crackle with accusations about lies and counter-lies.

The Republicans now have all the material that they need to do what they do best. Mr Obama is an Ivy-League-educated intellectual whose associates include unrepentant terrorists and swivel-eyed preachers. Mr McCain's running-mate, Sarah Palin, is a Nixonian fantasy come true, perfectly designed to create a cycle of accusation and counteraccusation. The "liberal media" cannot do its job without questioning Mrs Palin's qualifications, which are astonishingly thin; but they cannot question her qualifications without confirming the Republican suspicion that they are looking down on ordinary Americans. "Here's a little news flash for all those reporters and commentators," Mrs Palin told the Republican convention, doing her best to channel Agnew. "I'm not going to Washington to seek their good opinion—I'm going to Washington to serve the people of this country."

Nixon's original insight remains as true now as it was in the late 1960s: lots of liberals do, indeed, look down on flyover Americans as stump-toothed imbeciles and, for some strange reason, lots of flyover Americans resent them for it. What is more, the culture wars have intensified since Nixon's last election, supersized by the *Roe v Wade* decision on abortion in 1973.

Not victims but victors

Yet the Republican Party's decision to rely so heavily on Nixon's 1972 template is nevertheless depressing. Aren't Republicans supposed to deplore the politics of victimhood? Conservatives make a good case that treating minority groups as victims diminishes America and institutionalises dependency. But when it comes to election-time they not only play the politics of victimhood, but play it with extraordinary relish, presenting ordinary Americans as the victims of diabolical conspiracies.

Haven't Republicans done quite well when it comes to power? They have controlled the White House for 28 of the past 40 years, and have a solid majority on the Supreme Court. And aren't Republicans rather good at getting their message across? Nixon was justified in feeling that the press liked to kick him around. But the past 30 years have seen the emergence of a conservative media establishment that excels at kicking liberals around, not least Fox News and talk radio. Nixon at least had the excuse that he spent his life as an outsider, despite his intellectual gifts and relentless hard work. Mr McCain is the ultimate insider: the offspring of a naval dynasty, a bad boy turned war hero, the media's favourite Republican.

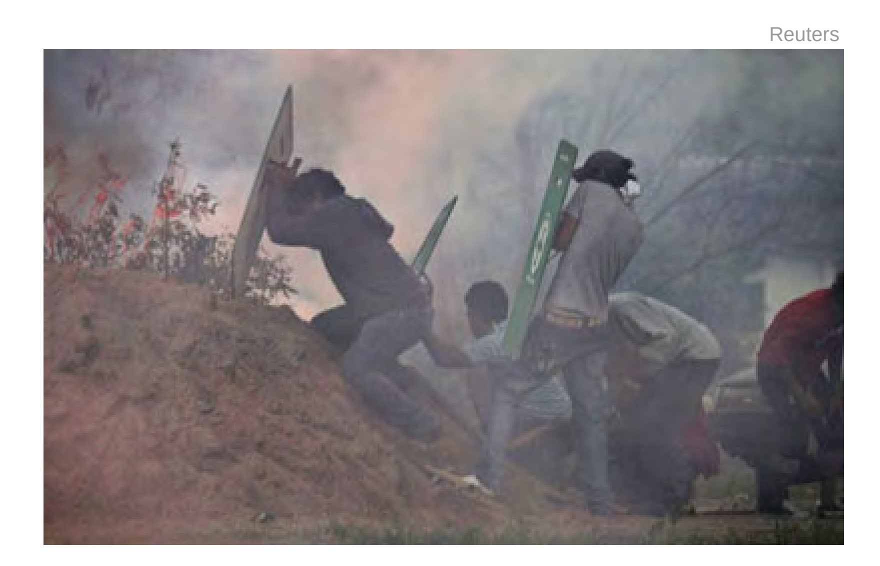
The bigger question is whether the politics of resentment will be enough on its own to win an election. Rick Perlstein, the author of "Nixonland", points out that, from Nixon's time onwards, "culture" has always been just one part of the Republican trifecta, which also includes economic management and foreign policy. Richard Nixon and George Bush senior offered mastery of foreign policy. Ronald Reagan offered a revolutionary mixture of free-markets at home and assertiveness abroad. But this year the Republicans are left with nothing but a culture war to sell to the voters—Richard Nixon with the redeeming features left out.

Bolivia

Now put it back together

Sep 18th 2008 | SANTA CRUZ AND LA PAZ
From The Economist print edition

Reuters



A political standoff turns deadly, but bloodshed may bring both sides to their senses. At least they have agreed to start talks

PLAN TRES MIL is a neighbourhood on the outskirts of Santa Cruz, made up of mud roads and outdoor markets. Its inhabitants are mostly indigenous Bolivians from the western highlands, and after days of constant harassment, they are angry. Their tormentors are radical young militants from the Unión Juvenil Cruceñista (UJC, the Union of Santa Cruz Youth), armed with clubs, shields and, some say, firearms, who have roughed up indigenous street traders and supporters of President Evo Morales's socialist government.

“With this authoritarian Indian president we have to defend ourselves at all times,” explains Victor Hugo Rojas, a Unión Juvenil leader. (Mr Morales is Bolivia's first indigenous president.) But those on the receiving end of the increasing violence see it differently. “We cannot stand this any more,” says Portugal Quispe, an indigenous leader in the town.

The conflict tearing at Plan Tres Mil is being played out across Bolivia. The country has always been split between a minority of whiter, wealthier Bolivians of European descent, who tend to live in the prosperous tropical lowlands, and the darker, indigenous people concentrated in the impoverished high plains. But the divisions are now deeper than ever.

At least 30 people have been killed in clashes between the opposing camps. For the past three weeks, anti-government protesters have mounted roadblocks in energy-rich south-eastern Bolivia, stormed government buildings and seized gas fields near pipelines carrying gas to Brazil and Argentina. So far, Bolivians have avoided falling into a fully-fledged civil conflict. But a week of escalating street battles has brought the possibility much closer.

The violence erupted after Mr Morales decreed on August 28th that a referendum would be held on a new constitution. The vote is due to take place on January 25th. The changes are opposed by most lowlanders; Mr Morales refers to them as privileged “oligarchs” intent on his overthrow and on denying indigenous Bolivians their rightful share of the country's natural gas, minerals and land. They, in turn, suspect the president of trying to turn the country into a satellite of Venezuela and Cuba.

The opposition is being led by conservative regional governors from the five eastern departments of Beni, Chuquisaca, Pando, and gas-rich Santa Cruz and Tarija. Soon after the referendum

was announced, opposition governors, most of whom have won local ballots supporting regional autonomy, launched a campaign of civil disobedience that quickly descended into violence.

On the night of September 10th, hundreds of protesters overpowered soldiers protecting a big gas field. Early the next morning another group of protesters started closing valves and overriding safety devices on a main gas-export pipeline close to the town of Yacuiba. Their action resulted in a huge gas leak and subsequent explosion that interrupted gas exports, costing $8m-10m a day in lost revenues and tens of millions more in damages to the pipeline. The line connects Bolivia's largest gas fields to Brazil, and supplies around half of all its natural gas.

But it was in the sparsely populated northern Amazon, near the town of Porvenir, far from the main battleground in the east, that the violence came to a head. On September 11th a pro-government demonstration in the regional capital, Cobija, ended in a bloodbath when rival gangs opened fire on each other. Bodies are gradually being recovered from a river. The official death toll has so far reached 15, with a further 106 people still missing.

Each side accuses the other of arming illegal paramilitary groups. The government was quick to describe the killings as a genocidal massacre authored by the opposition regional governor, Leopoldo Fernández, of the Pando department, and immediately ordered troops to impose martial law. On September 16th Mr Fernández was arrested, in violation of the immunity granted to such officials. In response, the opposition first pulled out of talks with the government, but has now said it is willing to join in after all.

Bolivia's crisis is already spreading beyond its borders. Mr Morales has frequently accused the United States ambassador in Bolivia, Philip Goldberg, of collaborating with rebel prefects and of seeking to break up the country. Mr Goldberg's previous job in Kosovo apparently makes him highly suspicious. As the violence escalated, Mr Goldberg was expelled for allegedly fomenting rebellion.

Bolivia can hardly afford this posturing. On September 16th the United States declared it to be "non-compliant" in the war on drugs, which will lead to an end to American aid. Even more worrying is the threat to the thousands of jobs that currently depend on duty-free access to the American market under the Andean Trade Promotion and Drug Eradication Act, which is due to expire at the end of this year. Venezuela's president, Hugo Chávez, followed suit, expelling America's envoy to Caracas in solidarity with Bolivia (see article). The Bush administration has responded in kind, expelling the Bolivian and Venezuelan ambassadors to Washington and urging United States citizens to leave Bolivia.

Mr Chávez has repeatedly said he would not stand idly by if Mr Morales were threatened by the opposition. He even pledged, theatrically, to die in Bolivia's defence if necessary. But suspicions of Mr Chávez are so widespread in Bolivia that troops flown into Cobija were met by protesters convinced that this was a long-feared Venezuelan invasion. A flustered army colonel leading the operation had to insist he was Bolivian. His equally nervous troops briefly opened fire, killing two bystanders and injuring others, before order was restored.

Alarmed by the crisis, neighbouring governments have responded with support for Mr Morales. At an emergency meeting of the 12-member Union of South American Nations (Unasur) on September 15th, the nascent organisation pledged to send a delegation to Bolivia to establish a dialogue between the government and representatives of the eastern provinces. The six-hour meeting was marked by tension between the region's two big powers: Brazil, nervous about disruptions to supplies of gas from Bolivia, and Venezuela.

A pause in the violence should create room for talks. But the differences between the two sides are so wide and their supporters so inclined to take matters into their own hands that international mediators face a monumental task: first to broker a deal, and then to ensure both sides keep their pledges.

Venezuela

Back on his old hobby-horse

Sep 18th 2008 | CARACAS
From The Economist print edition

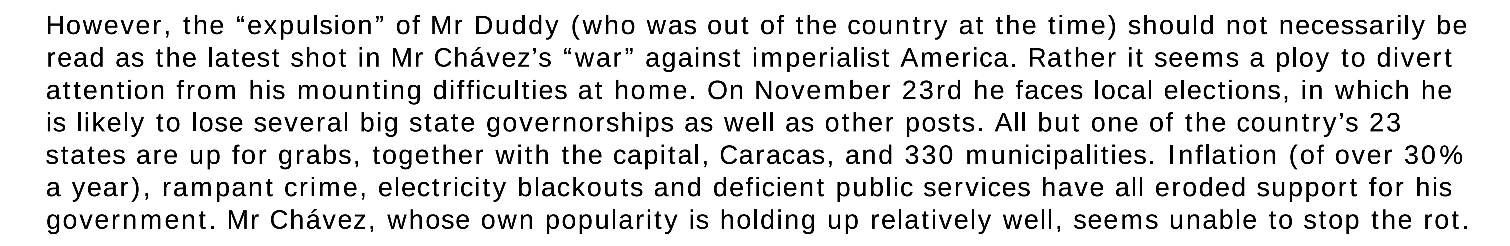
But there are limits even to Hugo Chávez's anti-Americanism


Illustration by Claudio Munoz

IF EXPELLING ambassadors ever became an Olympic sport, Venezuela's president, Hugo Chávez, would have few rivals for gold. In almost a decade in power, the garrulous leftist has provoked serious diplomatic breaches with Mexico, Peru, Chile and, repeatedly, neighbouring Colombia. Several other governments have felt the lash of his unbridled tongue.

On virtually every occasion, Mr Chávez argued that the true culprit was the Bush administration and its desire to see the back of him. Vicente Fox, then Mexico's president, was a "puppy of the empire"; Colombia's Álvaro Uribe "a sad pawn". The Venezuelan president insists that the United States has never stopped scheming to overthrow, and even assassinate, him. The latest alleged plot is currently prompting arrests and interrogations in Caracas, while provoking widespread scepticism among commentators.

Yet despite calling Mr Bush everything from a drunkard to a donkey—and even, on one memorable occasion, the devil—Mr Chávez had stopped short of declaring the United States' ambassador to Venezuela *persona non grata*. But on September 11th Patrick Duddy, who had held the post for just a year, was given 72 hours to leave the country. The stated reason was hardly convincing: the step was taken "in solidarity with Bolivia" (whose own president had just done something similar), said Mr Chávez. Although he stressed that there was no immediate threat to commercial ties with the United States, the Venezuelan leader pledged to cut off oil supplies if there was any "aggression" against his country.



However, the "expulsion" of Mr Duddy (who was out of the country at the time) should not necessarily be read as the latest shot in Mr Chávez's "war" against imperialist America. Rather it seems a ploy to divert attention from his mounting difficulties at home. On November 23rd he faces local elections, in which he is likely to lose several big state governorships as well as other posts. All but one of the country's 23 states are up for grabs, together with the capital, Caracas, and 330 municipalities. Inflation (of over 30% a year), rampant crime, electricity blackouts and deficient public services have all eroded support for his government. Mr Chávez, whose own popularity is holding up relatively well, seems unable to stop the rot.

Internationally, his standing has been affected by a number of scandals. Several top government officials have been tainted by serious corruption allegations in a trial currently under way in Miami. On September 12th Venezuela's two most senior intelligence officers and a former interior minister were placed on a United States' Treasury Department blacklist for allegedly collaborating with Colombian terrorists and drug-traffickers. More damning revelations are expected.

Meanwhile, the price of oil—on which Venezuela depends for over 90% of its export earnings—is tumbling. At a press conference this week, the president said he was "not at all alarmed" by the fact that Venezuelan oil had fallen to under $90 a barrel. Yet leading economists point out that the current level of imports would become unsustainable if oil were to drop to $75. By September 18th the price had rallied slightly.

Venezuela's dependence on oil—and in particular on oil sales to the United States, its main trading partner—explains why Mr Chávez's threats to cut supplies have not gone beyond the rhetorical. This calculation has also helped induce a note of caution in Washington. The State Department reacted more in sorrow than in anger at the expulsion of its ambassador, simply saying it did not help the people of Venezuela "one bit".

A policy of supplying cheap, or virtually free, oil to allies has so far kept most of Venezuela's neighbours happy. But it has also tied the country ever more closely to the United States' market, almost the only one that pays. And if the oil price continues to sag, the limitations of the policy will become obvious, particularly if Mr Chávez insists on flouting elementary rules of non-interference in his neighbours' affairs—as he did this week over Bolivia.

As violence was spreading in the northern Bolivian department of Pando, the Venezuelan president launched a virulent attack on the head of the Bolivian armed forces for his alleged failure to defend democracy. Mr Chávez had already said that Venezuela would support an "armed movement" in Bolivia if President Evo Morales were overthrown. The general in question, and later the Bolivian defence minister, lashed back, insisting that their country would resolve its problems on its own, thank you. Neither succeeded in silencing him.

Mr Chávez's subsequent attempt to use a meeting of the 12-member Union of South American Nations in Santiago as a platform to condemn the United States was headed off. But Chile's foreign minister, Alejandro Foxley, complained that it had nearly wrecked the summit.

There is no evidence that the United States is secretly plotting to overthrow the Venezuelan government. Many observers, including Moisés Naím, a former Venezuelan minister of trade and industry and now editor of *Foreign Policy* magazine, have concluded that the truth lies elsewhere. "They see," Mr Naím wrote in a Spanish newspaper, *El País*, this week, "a politician making use of the old trick of alleging *yanqui* imperialism in order to distract the unwary."

Cuba

Bloodied, but unbowed

Sep 18th 2008
From The Economist print edition

Desperate for international aid, hurricane-torn Cuba turns down any relief from its old foe, the United States

AP



Gustav and Ike woz here

"NEVER in the history of Cuba have we had a case like this," President Raúl Castro lamented after two powerful hurricanes, barely a week apart, struck the island, severely damaging crops and leaving some 200,000 homeless. Miraculously, Havana, the capital, was left virtually unscathed, as were the main tourist resorts, the oil industry and nickel mining. But with estimated losses of $5 billion, one of the world's last communist regimes is facing a daunting task.

The enormous damage sustained to the island's food supplies, housing and electricity grid raises big questions about Cuba's ability to get by without massive international aid. Two of the island's most valuable export crops, citrus and tobacco, suffered big losses. Luckily, the tobacco harvest was already in, but some 3,000 curing sheds where the leaves are stored were damaged. Almost half the sugarcane fields were flattened. The coffee harvest in the east has also been badly affected.

The government has admitted that it cannot cope alone. "It is impossible to solve the magnitude of the catastrophe with the resources available," said Carlos Lezcano, director of the National Institute of State Reserves. "The reserves are being tested. We shall have to prioritise."

Hurricanes Gustav and Ike could increase pressure on Raúl Castro to accelerate reforms to loosen the island's centrally-controlled economy, much as his brother, Fidel, was forced to do in the early 1990s after the collapse of Cuba's subsidised trade with the Soviet Union. Back then, reforms briefly opened the economy up to private enterprise, but Fidel Castro slammed the door shut again once the economy had recovered.

Since his brother fell ill in July 2006, Raúl has stressed the urgent need for Cuba to raise its domestic agricultural production to substitute for increasingly expensive food imports. To that end, he has introduced measures to redistribute idle land and allow farmers more autonomy. After years of decline, the agricultural sector had begun to show signs of modest recovery, with output up 5.5% last year. Citrus production rose 20%, having fallen by 41% over the previous three years. Sugar cane was also making a comeback.

In the aftermath of the storms, Cuba's main allies leapt to the rescue. Russia sent four large cargo planes carrying 200 tonnes of relief supplies. Brazil and Spain sent smaller shipments. Venezuela is expected to make a big contribution, though details are not yet known.

But not even hurricanes of this ferocity could break down the lack of trust between Cuba and its old foe, the United States. Instead, the two have plunged into yet another round of political argy-bargy. The Bush administration offered Cuba $100,000 in immediate relief aid, later raised to $5m, but Mr Castro turned it down, demanding instead that America lift its trade embargo to enable it to buy urgently needed reconstruction materials. (In neighbouring Haiti by contrast, where the storm damage was worse, the United States promptly dispatched a helicopter-laden warship to help relief efforts, as well as pledging $19.5m in aid.)

In Havana, food markets are already running out of supplies and prices have shot up. Although some Miami-based Cubans may be eagerly anticipating anti-government protests, analysts do not consider this is on the cards—unless the government bungles the relief effort. “It’s rather unlikely that sweating and starving Cubans go rioting in the streets, even less so against a government that has been effective in disaster preparation and response,” said Johannes Werner, editor of *Cuba Trade and Investment News*. “Cubans have a track record of coming out stronger in far worse situations,” he noted.



WORLD
ASIA

Pakistan's tribal areas

A wild frontier

Sep 18th 2008 | LAKKI MARWAT, MAIDAN AND PESHAWAR
From The Economist print edition

It will take more than American missiles to bring order to Pakistan's north-western border region

Reuters



Get article background

AMERICA and Pakistan both deny it; but it appears that on September 15th they fought a short war. America started it. Local reports suggest that, under cover of darkness, two helicopter-loads of its soldiers crossed on foot from Afghanistan into the Pakistani tribal area—and terrorist haven—of South Waziristan. This followed an American policy, allegedly authorised by President George Bush in July, of launching raids into Pakistan without its government's approval. But, on this occasion, Pakistani border troops responded as to the act of aggression that it constituted: shooting over the heads of the advancing Americans, forcing them back.

Pakistan has, since 2001, been a vital American ally, which makes American policy towards it confused. So, for related reasons, is Pakistan's towards its own north-west tribal areas; and the ramifications could hardly be greater. A ruggedly inaccessible region, the tribal areas form a hinge between Pakistan and Afghanistan. By manipulating the sentiments of the 3.5m Pushtun tribesfolk who live there, past rulers, including British colonial administrators and Pakistani dictators, have sought to influence events in Afghanistan, where Pushtuns also predominate. In this way, the Soviet army was driven from Afghanistan in 1989—by American-armed mujahideen. But now, in a sadly predictable repetition, it is America and its allies that attract the tribesmen's wrath.

North-west Pakistan, and the seven, semi-autonomous tribal "agencies" in particular, has emerged as the main refuge and supply-route for Taliban insurgents on both sides of the border. The leaders of al-Qaeda, displaced from Afghanistan, are also there. And so are other stray Islamists, including Pakistani jihadist groups trained by the army to fight in Indian-held Kashmir, and lately discouraged from doing so.

Most of these fighters are probably drawn to the region to kill NATO troops and their local allies in Afghanistan. Indeed this is a big reason why the reconstruction effort there may be failing. Some 1,500 civilians have been killed in Afghanistan this year—roughly half of them by Western troops. In a bleak assessment of the progress of the war, Admiral Mike Mullen, chairman of America's joint chiefs of staff, this month suggested that "time is running out" to turn things around.

Hence Mr Bush's new policy. Hitherto, America had launched just a few missile attacks on suspected al-Qaeda targets in north-west Pakistan, in consultation with the government; three were reported in 2007. Meanwhile, since soon after America invaded Afghanistan in 2001, it has paid the Pakistani army to wage a counter-insurgency campaign in the tribal areas. To sustain 120,000 Pakistani troops in the field, at the latest count, including a 60,000-strong locally-raised frontier corps, America has given some $12 billion.

It has not got value for money. The border remains a militant thoroughfare. And in Pakistan, Taliban-style militancy has spread deep into the North-West Frontier Province (NWFP) and beyond. In the past year some 1,500 Pakistanis have been killed by terrorism and insurgency, mostly in or emanating from the north-west. On September 6th, as an electoral college chose Asif Zardari as Pakistan's president, a suicide-bomber drove into a police check-post in Peshawar, NWFP's capital, killing 37. A few days earlier bearded gunmen ambushed an American diplomat in the city, spraying her car with bullets.

No wonder Mr Zardari, Pakistan's first civilian leader in nine years, says the Taliban have the "upper hand" in Pakistan. Mr Bush seems to agree. By ordering unilateral American action, he presumably hoped to goad the Pakistani army to do better, and also to kill a few al-Qaeda types, including Osama bin Laden, the most famous of all supposed frontier tourists, before his presidency ends in January.

Mr Bush's new aggression was first unveiled on September 3rd with an American airborne assault on the village of Jala Khel, in South Waziristan, which, American officials claimed, killed a score of al-Qaeda militants. The army and journalists in Pakistan said the victims were civilians. The army chief, General Ashfaq Kayani—hand-picked and American-approved successor in that job of America's former ally, Pervez Musharraf—denounced the attack and vowed to defend Pakistan's territory "at all cost", and an army spokesman said American invaders would be shot. Mr Zardari's government also vowed to defend Pakistan's borders. It had little choice: one recent poll showed that four-fifths of Pakistanis oppose America's striking al-Qaeda within their territory.

But neither Mr Zardari's government nor Mr Bush's can afford an out-and-out rift. Visiting Islamabad this week, Admiral Mullen struck a more conciliatory note. Both sides talked up the prospects for co-operation. But Pakistan's foreign minister said his government had not been forewarned of an attack by an American drone in South Waziristan on September 17th that killed some militants.

Alas, one reason why Pakistan has failed to bring order to its side of the frontier does seem to be its reluctance to abandon its jihadist proxies. Otherwise, it is hard to explain why Pakistan has captured more fugitive leaders of al-Qaeda than of the Taliban, its former clients. To outsiders, this policy looks contradictory at a time when the Pakistani army is fighting a war against the Taliban and its affiliates, in which over 1,500 soldiers have been killed. But the army's Inter-Services Intelligence (ISI) agency, masters of strategic doublethink, might call it "selective"—a policy of squashing the militants at home, but still employing them abroad.

Afghanistan and India have always subscribed to this analysis of the ISI. Adding weight to it, Pakistan's army has increasingly come to blame its failures at the frontier on foreign support for the militants there, chiefly from India and Russia. The suicide-bombing of the Indian embassy in Kabul in July was allegedly the army's response to this. The suspected culprits were led by Jalaluddin Haqqani, an Afghan jihadist, sometime resident in the Pakistani tribal agency of North Waziristan and an ISI "asset". American and Indian officials accused the ISI of involvement in the bombing, which killed over 40 people.

Even if they tried

Yet a devious Pakistani strategy of failing to crack down on cross-border violence is not the only reason it persists, nor the main one. A better explanation, given the fraught, radicalised and ungoverned state of north-western Pakistan, and the many dead soldiers there, is that the army could not make a much better fist of controlling the border, even if it did its damnedest. And moreover, it may be afraid to pursue its campaign more vigorously, for two reasons. Pakistani officials suggest that, despite battling the Pakistani Taliban in the tribal areas, the army is reluctant to attack the Afghan Taliban, allegedly led from Peshawar and from Quetta, capital of Baluchistan province, for fear of worsening security problems in those places. Secondly, the campaign is unpopular, in the army and elsewhere, precisely because Pakistanis think it is being waged for America.

An opinion poll last year found only 48% of Pakistanis backed military action against the Taliban. The army may be just as divided. Several hundred demoralised soldiers surrendered last year to militants in South Waziristan and Swat, a mountainous region of NWFP north of the tribal areas; some said they refused to fight their brother Muslims. Many Pakistani leaders espouse similar views.

From within the cool colonnades of his office in Peshawar, Owais Ghani, NWFP's governor, says America should reach an accommodation with Mr Haqqani and Afghanistan's other main rebel leaders: the Taliban's Mullah Omar; and Gulbuddin Hikmatyar, another sometime Pakistan-backed, American-financed, jihadist. This would mimic Pakistan's own strategy. In a time-honoured fashion, the army has tried to batter mutinous tribals; then secure deals with them on its terms. The results have been at best mixed.



In the western part of South Waziristan, by exploiting existing tribal animosities, the ISI has found a friend in Mujammad Nazir. The army claims that his Wazir clansmen killed around 250 Uzbek militants in their midst last year. In North Waziristan, after several abject failures, the army claims to have a deal with the dominant Daoud clan. This, says the army, binds the tribesmen not to conduct raids into Afghanistan, or harbour foreign militants, on pain of having their houses demolished. As a sweetener, the army promises to build them roads, schools and clinics. America has cast grave doubt on the efficacy of this deal in particular.

Elsewhere, by the army's own admission, its strategy has failed. It has made a string of failed deals with South Waziristan's most powerful warlord, Baitullah Mehsud, a former fitness instructor and enemy of Mr Nazir. Mr Mehsud violated the last of these after the army invaded a jihadist mosque in Islamabad last year. He has since emerged as the Pakistan Taliban's strongest leader, and is accused of masterminding much jihadist violence, including the assassination of Mr Zardari's wife, Benazir Bhutto, in December. But despite an army attack on his fief in January, pitting 40,000 troops against a few thousand militants, Mr Mehsud remains in control of it. In May he held a press conference there.

Pacts Pakistana

Pakistan's army spokesman, General Athar Abbas, concedes that this was embarrassing. He says the army's error was to cut deals with the militants themselves; it should have made them instead with tribal elders. But it would have been hard-pressed to do so in South Waziristan, where the militants have murdered 120 pro-government elders. That may be why Mr Abbas adds that the army hopes to forge yet another pact with Mr Mehsud.

For now, it cannot fight him, partly because it has its hands full elsewhere. In the past month the army has taken its campaign to Bajaur agency, an alleged hideout of Mr bin Laden's right hand, Ayman al-Zawahiri. It claims to have killed over 700 militants, including foreign fighters fleeing newly-inhospitable North Waziristan. "It is time to give the militants a proper thrashing," says Ghulam Qadir, a senior official in Bajaur. But many locals, who include some 300,000 displaced by the fighting, accuse the army of killing civilians and often behaving no better than the militants. "There is a perception that the government and the militants are the same," said Akhunzada Chattan, a local politician.

Meanwhile in Swat, formerly popular with honeymooning couples, the army is waging a bigger assault—against an affiliate of Mr Mehsud's, a former ski-lift operator called Mullah Fazalullah. He is another former beneficiary of a peace deal; it did not deter his followers from burning 130 girls' schools to ashes. Mingora, Swat's regional capital, is now under siege, its official buildings pocked by bullets and blackened by suicide blasts. Some 15,000 soldiers are bunkered there, while Mr Fazalullah's men hold the surrounding hills. A local newspaper editor rubbishes the army's claims to have killed many militants. Wearily, he proffers a letter sent by the Taliban: "Those without beards, those who drive on the left like

the British, those who sell shaving kits, make-up or bras will be killed."

Perhaps only a minority, in Swat and elsewhere, support such edicts. In the few places where tribal elders have resisted the militants, the Islamists have been shown to have little support. In Lakki Marwat, home to Pakistan's second-biggest Pushtun clan, a florid-faced hereditary ruler called Anwar Kamal has maintained a firm and secular grip. By way of explanation, he said: "I told the Taliban, in traditional language, that the next time I see a Talib on my land I am going to screw him as hard I can." But alas, leaders like Mr Kamal are rare.



Economist.com WORLD ASIA

China’s baby-milk scandal

Formula for disaster

Sep 18th 2008 | SHIJIAZHUANG
From The Economist print edition

The politics of an unconscionable delay

“QUALITY and safety are the foundations of social harmony,” proclaim posters at the headquarters of the Sanlu Group in Shijiazhuang, capital of China’s northern province of Hebei. Sanlu was until recently one of China’s biggest producers of milk powder. Now, dozens of people, many clutching infants, queue in the hot sun outside to return powder that could be contaminated with a potentially lethal chemical. The harmony of China’s consumers has rarely been so tested.

The safety scandal engulfing not only Sanlu, fingered as the main culprit, but much of China’s dairy industry, is an embarrassment to China’s leaders. In July last year, after widespread complaints at home and abroad about tainted Chinese-made food and medicine, the authorities executed a former head of the country’s food-and-drug safety agency for taking bribes. This year, to improve monitoring, the agency was put under the Ministry of Health. The sale of tainted milk powder, which has so far made more than 6,000 infants ill and killed four, shows controls remain dangerously slack.

The government blames middlemen who collect milk from dairy farmers. They allegedly added water to increase its volume and, to disguise this, mixed in melamine, a chemical used to make plastics, which can deceive inspectors about the milk’s protein content. Melamine gained notoriety last year when several pets in America died after eating food contaminated with it by Chinese-made additives.

The central government has boasted it was quick to react to the latest problem. But the chronology revealed so far suggests otherwise. It has fuelled speculation of a delay to make sure the Olympic games in August were not marred by a food scare.

The government of Gansu province in China’s west says it told the Ministry of Health on July 16th about an unusual upsurge of kidney stones among infants who had all drunk the same brand of milk. It was not until September 1st that the ministry says its experts tentatively concluded that the powder had caused the sickness. Still, nothing appeared to happen.

Prodding from the government of New Zealand may have been what eventually goaded the Chinese authorities into action. On September 8th it told them what it had learnt from Fonterra, a New Zealand dairy company that owns 43% of Sanlu. Fonterra says it was told by Sanlu of a problem with the powder on August 2nd, six days before the games.

Helen Clark, New Zealand’s prime minister, said Fonterra had tried “for weeks” to persuade local officials to allow a public recall. Instead, in an unpublicised recall, powder was withdrawn from shops. Fonterra has defended its decision to keep its information under wraps for so long. “If you don’t follow the rules of an individual market place then I think you are getting irresponsible”, says the company’s chief executive, Andrew Ferrier.

Eventually, on September 11th, Sanlu announced a nationwide recall of 700 tonnes of powder. Two days later the Ministry of Health gave its first news conference on the crisis and the cabinet declared a national food-safety emergency. A government investigation found smaller traces of melamine in milk powder from 21 other companies, including leading brands such as Inner Mongolia Yili Industrial Group (an Olympic sponsor, though the government says no melamine got into the dairy supply for the Olympics or the Paralympics, which ended this week).

Heads are now rolling. Several milk dealers have been arrested. The mayor of Shijiazhuang has been dismissed. Sanlu’s boss, Tian Wenhua, has been fired and arrested. Around the country, milk powder is being withdrawn from shelves, leaving, as one Western expert on China’s dairy industry puts it, “not much but Nestlé”, a Swiss group whose milk powder is not implicated in the scandal. Sanlu’s production has been halted. Some other companies are recalling their milk powder too. The government has extended its investigations to a variety of dairy products.

But officials still appear nervous about public reaction to the news. Chinese journalists say the Communist Party's Propaganda Department has ordered all but the party's most trusted media to refrain from investigating the story. At Sanlu's headquarters people lining up to return their powder complain that the local press has barely covered the issue.

Extra police have been deployed around Sanlu's headquarters and the city's main children's hospital. Across China, anxious parents are flocking to have their infants tested for kidney stones. One grandparent blames the scandal on corrupt collusion between dairy businesses and local officials. "It would not have happened in the days of Mao Zedong," he says. Harmony has yielded to discord.



WORLD ASIA

China's mid-autumn festival

More than they can chew

Sep 18th 2008 | BEIJING
From The Economist print edition

One derivatives market still thrives

Illustration by David Simonds



FOR the first time, China's citizens enjoyed an official day off on September 14th to celebrate one of their best-loved traditions, the mid-autumn festival. As usual the occasion was marked by gifts of stodgy pastries known as mooncakes, often containing a solid yolk representing that day's full moon. But mooncakes have come to mean much more.

Gift-giving in China is often about showing off status and storing up goodwill that might one day produce favours. With the rapid growth of an urban middle class, mooncakes have become a form of currency, not so much to be eaten (some Chinese confess to disliking them) as to be given with careful thought as to the cost of their ingredients and the lavishness of their packaging.

This is especially true if the recipient is a potential favour-giver. The higher a person's status, the more mooncakes he is likely to receive and the more exotic they will be. So rich are the sweet and salty delicacies that few would eat their way through an entire gift pack on their own. Unwanted packages are often discreetly handed on to others, creating a cascade of calories and goodwill.

In recent years officials have repeatedly called on manufacturers to use less elaborate packaging in order to cut down on waste and make mooncakes more affordable. A survey cited by China's official news agency, Xinhua, said 78.8% of those polled disapproved of the fancy packaging (sometimes a bottle of wine or spirits is wrapped up with the cakes), and 69.3% said it infringed their rights because it made mooncakes too expensive. But mooncake-makers, knowing where the profits are, have paid little heed.

Fortunately there is hope for consumers in the form of a market in mooncake derivatives. Mooncake coupons are often given out by companies to employees, to exchange for the real thing. Or they can sell them to others at a discount to the mooncakes' market price. The trading season is short and frenetic: the coupons are nearly worthless once the holiday is over. Like Christmas cake, mooncakes are rarely consumed out of season.

Such is liquidity in this market that a cash-strapped hotel in the central city of Wuhan reportedly decided to use the coupons as part-payment for a decorating job. The unamused contractor, it is said, refused to bite.



Japanese politics

Not quite a one-horse race

Sep 18th 2008 | TOKYO
From The Economist print edition

As the congenial Taro Aso steps forward, the LDP's fate hangs in the balance

EPA



Japan's politics

IF YOUR notion of Japan's ruling party is that after half a century in near-continuous power it is unrepresentative, out-of-touch and incompetent, the Liberal Democratic Party (LDP) would like you to think again. In the days since Yasuo Fukuda abruptly announced his resignation on September 1st—the second occasion in a year for the ruling coalition to lose a prime minister—television has been filled with a razzle-dazzle race to lead the LDP. The winner of that contest (the party votes on September 22nd) will automatically become prime minister at a special session of the Diet (parliament) on September 24th.

When Mr Fukuda said he was resigning, it seemed as if Taro Aso, the LDP secretary-general and a former foreign minister (on the right, above) would be pushed smoothly into the post, just as Mr Fukuda and Shinzo Abe before him were as good as picked by the party grandees behind closed doors. However, four other Diet members have put themselves forward, including the first woman to run for prime minister in Japan, Yuriko Koike (also pictured). It's invigorating stuff, the LDP hopes, stealing the opposition's thunder and showing up its hidebound style. For on September 8th the Democratic Party of Japan (DPJ) re-elected its own leader, Ichiro Ozawa, an old bruiser, unopposed. The LDP is even brazen enough to declare that the DPJ's inexperience at governing must necessarily reflect ill upon its presumed competence—as if the opposite held true for its own shambles of a government.

Moreover the race appears to be not just about personalities but policies—surely a first for the LDP. Boosters say it is really about the choices the country faces. On what Japan needs to do, Mr Aso is among the least articulate of the contenders, though he makes up for it with a cheerful air, earthy humour and (untypically for Japan) an evident hunger for the top job. This week the Japanese establishment watched with mounting alarm as famous American financial firms imploded. Mr Aso's recipe for dealing with the consequences for Japan, and for reviving the sluggish economy, is to push for a fiscal-stimulus package. He argues that budget commitments to tame Japan's enormous national debt should be put off. Mr Aso served under Junichiro Koizumi, swashbuckling prime minister from 2001-06, but is no fan of Koizumi-style structural reform. If he believes in anything, it is in a rather hawkish conduct of foreign affairs.

By contrast, Mr Koizumi has come out of the shadows to anoint Miss Koike, a former environment and defence minister. She says the race "is a real struggle about whether reform takes place or not", and accuses Mr Aso of wanting to turn back to the LDP's old pork-barrel ways. Miss Koike vows to confront a powerful bureaucracy resistant to change. Meanwhile, her candidacy is causing a stir within the party, and not only because of her sex; it risks splitting the LDP's biggest faction, whose head backs Mr Aso. (Mr Koizumi, ever the iconoclast, no doubt approves of that too.)

The other candidates also have something to offer. Kaoru Yosano, the 70-year-old economy minister, is also for Koizumi-style reform, he says. However, his passion is to balance the books. Even with a slowing economy, Mr Yosano says, Mr Aso is reckless to propose abandoning the target of balancing the budget (before interest payments) by 2011. Shigeru Ishiba, a competent past defence minister, says he is running to stiffen Japan's resolve to take part in international peacekeeping and other operations. Nobuteru Ishihara, son of an outspoken Tokyo governor, mixes liberal reform with an unstuffy style.

For all this, Mr Aso is a firm favourite. So the contest risks, as one LDP member puts it, appearing to be merely a skit. After all, the candidates have a good chance of plum posts in an Aso government—even Miss Koike, who describes the LDP old guard voting for Mr Aso as "Pavlovian dogs" reacting to the stimulus of pork.

The new prime minister will swiftly form his cabinet, and then deliver his policy address to the Diet on September 29th. Mr Aso will urgently want to pass a stimulus package, and renew the Japanese navy's refuelling mission in the Indian Ocean, part of the international effort in Afghanistan. But the DPJ, which controls the upper house, vows to oppose both measures. So, says the LDP's Diet-affairs chief, Tadamori Oshima, a quicker way to get them passed may be to call a snap election—October 26th is the likeliest date.

For the LDP, much would be at stake in such a vote. Koichi Kato, a former party secretary-general, says that four-fifths of its Diet members are in the LDP not because of its policies, which are few, but because it is the party in power. It may well remain so after an election, but party veterans are fearful. "The winds of fortune", says Mr Oshima, covering his head with his hands, "are blowing away from us."



Malaysian politics

Bluff and counter-bluff

Sep 18th 2008 | BANGKOK
From The Economist print edition

Playing poker for the right to form a government

EPA



Follow me, says Anwar

FOR months the entire country had been nervously awaiting Malaysia Day, September 16th. And not just to celebrate the 45th anniversary of Sabah and Sarawak, Britain's colonies on Borneo, joining with the Malayan peninsula to form Malaysia. The opposition leader, Anwar Ibrahim, had been promising, since his alliance's strong showing in a general election in March, that by Malaysia Day he would convince more than 30 parliamentarians from the governing coalition to switch sides, thereby giving him a majority and allowing him to take power. Mr Anwar's sweeping victory in a by-election last month heightened the speculation that he was on track to keep his promise.

The big day arrived. The prime minister, Abdullah Badawi, and his deputy, Najib Razak, ostentatiously went about their business, ridiculing Mr Anwar's threat as a "mirage" and a "deception" respectively. Mr Anwar called a press conference to claim that he had "firm commitments" from enough government MPs to win power. He demanded a meeting with Mr Badawi to discuss a smooth handover. But still he did not name the supposed defectors. He has since called for parliament to be recalled from recess to hold a vote of no confidence in the government. Mr Badawi seems unlikely to agree to this or to meet Mr Anwar. The ruling coalition, led by the United Malays National Organisation (UMNO), has run the country uninterruptedly since the peninsula's independence from Britain 51 years ago. So is Mr Anwar's boast the bluff of the half-century?

Malaysians might have concluded thus had it not been for the signs of panic from the government over the threat from Mr Anwar, and its deep and widening splits over Mr Badawi's leadership. The "sodomy" charge brought in June against Mr Anwar by a male ex-assistant looked suspiciously similar to the bogus charges that brought him down in 1998, when he was the deputy, and chief rival, to the then prime minister, Mahathir Mohamad. Eight days before Malaysia Day, UMNO packed off dozens of its MPs on a supposed study tour of Taiwan, a blatant ploy to keep them away from Mr Anwar.

Then on September 12th three thorns in the government's side were arrested under Malaysia's Internal Security Act, a relic of British colonial rule that allows indefinite detention without charge. They included a pro-opposition blogger who had made sensational allegations against Mr Najib and an ethnic-Chinese opposition MP whose supposed offence had been to ask her local mosque to turn down its loudspeakers (she denied this).

The third detainee, released after 18 hours, was a journalist who had accurately reported racist comments by a minor UMNO official. The official had called the country's Chinese minority "squatters" and said they were power-hungry "like the Jews in America". The unrepentant official himself was not arrested, just suspended from party membership. This prompted the Malaysian Chinese Association, a party in the ruling coalition, to hint that its patience with UMNO's ethnic-Malay supremacists was close to exhaustion.

The detentions looked like the start of the wider crackdown that some fear a cornered UMNO might yet launch, to save its skin. But they succeeded only in widening the splits in the ruling party. The cabinet's leading reformist, Zaid Ibrahim, appointed recently to overhaul the politicised justice system, resigned and announced he now had an "open mind" about joining the opposition. Muhyiddin Yassin, the trade minister, called for the prime minister to step down early (he has already promised to hand over to Mr Najib in 2010). Several other ministers openly criticised the arrests.

Dr Mahathir—who has become a bitter critic of his successor as prime minister and had recently quit UMNO in a sulk—marked Malaysia Day by letting it be known he was rejoining, presumably to foment an

internal coup against Mr Badawi. The next day the prime minister said he might hand over to Mr Najib early and, in the meantime, would give him the finance minister's portfolio, hitherto held by himself. Shortly after, the Sabah Progressive Party, a small Borneo party with two MPs, said it was quitting the ruling coalition to go "independent".

For the opposition, the prospect of Dr Mahathir helping UMNO destroy itself is "exciting", as Nik Aziz Nik Mat, a leader of the Islamist Party, a member of Mr Anwar's alliance, gleefully put it. The disarray in the ruling party will do no harm to the opposition's hopes of gaining power. But it remains unclear if it has pushed enough disaffected government MPs to make the jump to Mr Anwar's camp. Malaysian pundits think Mr Anwar has lined up a fairly large group of potential defectors. But they reckon he can keep voters waiting only a little while longer before they start to wonder if he is no more to be trusted than the government he loves to lambast.

Australia's new opposition leader

Turnbull's turn

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Unconventionally, the Liberals pick a liberal

EVER since John Howard led it to a crushing election defeat to Labor last November, Australia's conservative Liberal Party has wandered in a political wasteland. On September 16th, still clamouring for a way out, it elected Malcolm Turnbull as its new leader. In doing so, the Liberals buried the rigid policy agenda that marked Mr Howard's 11 years in power. Mr Turnbull, a reformer, offers the Liberals their best hope of loosening the grip on public approval that Kevin Rudd has won in his first months as prime minister.

The speed of Mr Turnbull's rise took even him by surprise. He returned from a holiday just as Brendan Nelson, installed after the shock of the Howard defeat, called a vote to shore up his crumbling leadership. This rather stole the limelight from Peter Costello, a former aspirant for the job, with his bitter memoir attacking Mr Howard for not handing over to him, though he declined to stand himself this time. In a two-horse race, Mr Turnbull beat Mr Nelson by four votes.

At 53, and after only four years in parliament, Mr Turnbull will be a less conventional leader than any of them. A former journalist and lawyer, he made a fortune in the 1990s as a banker with Goldman Sachs and an entrepreneur who helped launch an internet company. His constituency, facing Sydney Harbour on one side and Bondi Beach on the other, is among Australia's richest. But Mr Turnbull says he knows how it is to be short of money and to live in rented flats. His mother, a writer and academic, left for America when he was still a child. He was brought up by his father.

Mr Turnbull has championed some policies long before his conservative party was ready for them: an emissions-trading scheme, an apology to indigenous Australians, ending discrimination against same sex couples (though not legalising gay marriage) and making Australia a republic. With the exception of the republic, the Rudd government is implementing all of these.

Mr Turnbull's bigger challenge will be to heal the Liberals' divisions, and to restore their reputation for economic management. He shares with Mr Rudd a personal authority not beholden to party bosses, and a desire to draw his party to the centre, away from its more doctrinaire traditions. Up to a point, that is.

Mr Rudd welcomed Mr Turnbull with a call for co-operation on a timetable for ending constitutional ties with the British monarchy. Mr Turnbull retorted this was now a lost cause as long as Queen Elizabeth reigned. Republicans bemoaned such a timid schedule, which might defer change until long after Mr Turnbull himself has left the political stage.



WORLD
ASIA

Politics in Bangladesh

The begums are back

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From The Economist print edition

Back to square one as the army admits defeat

AFP



Zia, free at last, and back in the battle

IT IS a spectacular military retreat. “You can smell the burning tyres,” says one Dhaka-based diplomat. Since the army seized power in January 2007 and installed a technocratic interim government, it has tried and failed to end an era of dominance by Bangladesh’s two squabbling former prime minsters, Khaleda Zia of the Bangladesh Nationalist Party and Sheikh Hasina Wajed of the Awami League.

Yet, after a year in jail on charges of corruption, Bangladesh’s battling begums are back. On September 11th the government freed Mrs Zia on bail. Five days later, it cleared legal hurdles for the return of Sheikh Hasina from America, where she went for medical treatment following her release on parole in June. She is expected back in Bangladesh early next month.

Both leaders still face charges. But prosecutors are unlikely to take action against them without the approval of the government, which is no longer trying to bring their political careers to an end. So, barring an extraordinary upset, one of them will be Bangladesh’s next prime minister.

It is an astonishing volte-face. The begums alternated in power from 1991-2007 and are blamed for the fiercely antagonistic, corrupt politics that led the army to step in. First it tried to exile them and create a “third force” in Bangladeshi politics; then it jailed them and tried to split their parties, hoping that new leaders might emerge. But the begums’ parties are held together by two things: patronage and personality cult. They are unviable without their leaders: hence the BNP’s offer to Mrs Zia this week to lead the party “for life”. She declined.

The good news is that Bangladeshis, for the first time since 2001, will get the chance to elect a government. For once it will be almost impossible to rig the poll. The election commission has purged 12m duplicate, deceased or otherwise bogus names from voter rolls. On September 22nd it will unveil a firm date for the election, long promised for December. And the government is soon to announce steps to lift the 20-month old state of emergency.

It is troubling, however, that Bangladesh’s transition to multiparty democracy has in effect been entrusted to the two politicians who made it unworkable in the first place. They have refused to talk to each other for decades, though the government says it is working on getting them to “sit across the table”.

The price the government had to pay to prevent the parties boycotting the polls is the return of total impunity to Bangladesh. For five years from 2001, Bangladesh led international corruption rankings. But this month the government freed Mrs Zia’s son, Tarique Rahman, the main trophy of its anti-corruption drive. The begums’ coteries have been released on bail. It seems likely that the convictions of those jailed for corruption will be overturned.

Some in Dhaka worry that all of this might be too much for the generals to stomach. The army still has to secure its own safe passage into the multiparty era, but has little clout over the resurgent political parties. The two years Western governments quietly granted it to fix the country’s messy politics are drawing to a close. Neither foreign governments nor Bangladeshis want to see its rule extended.

But there are hints that the generals might not leave politics altogether. A banned Islamist militant group, the Jama’atul Mujahideen Bangladesh, which the army previously claimed to have crushed, is reported to have threatened members of the emergency government. This week the home ministry gave warning of worsening law and order. The general’s retreat seems inevitable, but such scares suggest it might not be

total.

Zimbabwe

Can the new deal work?

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From The Economist print edition

Robert Mugabe no longer has unfettered power but Morgan Tsvangirai is not in control either. In a new power-sharing deal, no one knows who will emerge on top

Illustration by Peter Schrank



IT WAS not a promising start. As soon as the arch-rivals had signed their historic agreement and shaken hands in front of flashing cameras, Morgan Tsvangirai, the opposition leader, spoke of reconciliation and a hopeful future. But Robert Mugabe, sounding bitter and almost unhinged, railed against colonial evils, insulted the leader of a neighbouring country, Botswana, and poured vitriol on the American and British governments for their alleged meddling. Mr Tsvangirai put his head in his hands. Many in the audience, at a hotel in Harare, the capital, jeered. Outside, supporters of ZANU-PF, the party that has ruled Zimbabwe under Mr Mugabe's leadership for 28 years, clashed with members of Mr Tsvangirai's Movement for Democratic Change (MDC).

The document itself, drawn up under the mediating aegis of South Africa's embattled president, Thabo Mbeki, is riddled with ambiguity, contradictions and vagueness. Above all, it is unclear who is in charge. Nonetheless, whether or not it will create a government that can rescue the country from chaos and division, it marks a massive psychological shift for Zimbabweans. Its biggest achievement is that Mr Mugabe is no longer in sole control—a grievous blow to a party whose leaders had sworn never to let Mr Tsvangirai get a sniff of power and whose militias in the past six months have killed hundreds of supporters of the MDC with impunity. The momentum now favours Mr Tsvangirai. But it could still be reversed.

The key compromise is that Mr Mugabe will remain an executive president and Mr Tsvangirai will become an executive prime minister, rather along the lines of the settlement that ended the bloody crisis that followed Kenya's election nine months ago. Mr Mugabe will still chair the cabinet, which is supposed to draw up policy; Mr Tsvangirai will preside over a parallel council of ministers, which is meant to implement it. The Joint Operation Command embracing Mr Mugabe's top security men, which has been virtually running Zimbabwe as the post-election chaos has spread, will be replaced by a National Security Council, in which Mr Tsvangirai will have a seat.

It is unclear who will call the final shots in case of a dispute, though there will be a "Joint Monitoring and Implementation Committee", known as JOMIC, drawn from all parties. Most worryingly, there is no outside mechanism to knock heads together in case of deadlock. Mr Mbeki, the nearest thing to it, is suffering from a loss of authority back home (see article).

The composition of the government has yet to be agreed. ZANU-PF will get 15 of the cabinet's 31 ministries, Mr Tsvangirai's lot will have 13, and a splinter group of the MDC led by Arthur Mutambara will get three seats—and its boss will be one of two deputy prime ministers. So the combined MDC, which has a history of quarrelling, will have a wafer-thin majority. In any event, cabinet decisions, according to the document, are to be taken by consensus. Mr Mugabe will still appoint ministers, but "in consultation" with Mr Tsvangirai.

It is understood that Mr Tsvangirai will probably get the finance ministry, foreign affairs, the home ministry (crucially to include the police) and the main social-service ministries, while Mr Mugabe will hold on (no less crucially) to the army. It is unclear who will run the feared Central Intelligence Organisation. Mr Mutambara's faction may get a ministry for legal and constitutional affairs.

The constitution will immediately be amended to accommodate the deal's provisions; a new one is to be presented within 18 months of the formation of a unity government and then put to a referendum. At that point, the power-sharing government could go on to complete a five-year term or either party could bail out and force a general election. Numerous clauses in the document call for an end to violence and for general harmony and healing.

There is no specific provision for reforming the judiciary, which has lost most of its independence under Mr Mugabe. A number of opposition supporters, including some MDC officials and MPs, are still behind bars or on bail facing charges such as treason. Human-rights groups say that violence perpetrated mainly by ZANU-PF militias is continuing in the countryside; the party's torture camps have yet to be dismantled. The agreement makes no mention of an amnesty for perpetrators of political violence.

The document says the forcible land acquisitions of the past eight years, which have led to the expulsion of some 5,000 white farmers, who had underpinned the entire economy, are "irreversible"; the "former colonial power", namely Britain, should compensate the ousted farmers and pay for land resettlement. At the same time, it calls for property rights and security of tenure irrespective of race. It also calls for a land audit and for the abolition of multiple farm ownerships; Mr Mugabe's family is thought to have at least a dozen.

No one knows who'll be in charge

It is unclear how the deal, with its competing hubs of power, will work in practice or how the cabinet and the ministers' council will interact. The 84-year-old Mr Mugabe, who has proved adept at outwitting his rivals over three decades, will doubtless seek to neuter the 56-year-old Mr Tsvangirai's lot. Many remember how expertly he outmanoeuvred the late Joshua Nkomo, who led a rival liberation movement into a previous government of national unity in the 1980s, only to see his party and powers squashed by Mr Mugabe.

Civic organisations and the trade unions, from which Mr Tsvangirai and his MDC emerged, are nervous. But they are warily ready to see how quickly the new prime minister can produce results. As the American ambassador put it, an early simple test will be whether people wearing MDC T-shirts will be able to walk freely down the streets—and in the bush—without fear of assault or even murder by ZANU-PF thugs. Another will be the speed with which Mr Tsvangirai, whose party had previously secured the post of Parliament's agenda-setting speaker, can abolish the two catch-all laws that have hobbled the media and allowed the police to prevent opposition parties from holding meetings and generally operating freely.

Yet another test will be the ability of foreign charities, especially those providing food and medicine, to operate freely again; a three-month ban on their activities was recently lifted. It also remains to be seen whether foreign journalists, including those working for the BBC, the country's most listened-to Western broadcaster, will be allowed to work openly.

Will the deal convince foreign governments, global institutions and investors to open their wallets? Inflation is running officially at more than 11m% and probably, in reality, at more than 40m%, with the central bank printing an avalanche of money to cover a massive budget deficit. Last month, it slashed ten zeros from the currency but the rate has already slumped from 30 new Zimbabwean dollars to an American one, to 300 today. The bank says it will let some shops trade in foreign cash; petrol in some stations may also be bought in dollars or rand.

The central bank's governor, Gideon Gono, one of Mr Mugabe's closest confidants, will have to go. A

currency board may be set up to oversee what would in effect be a new currency, most likely pegged, at least at first, to the South African rand. The new government's first priority is to stabilise the currency. During that painful period, which could last several months, more shops will have to be allowed to sell in foreign currency. A massive cash injection from abroad is unlikely while hyperinflation is still at world-record rates.

The economy has shrunk by more than half in a decade; farming and manufacturing have collapsed; shortages of almost all essential goods, including cooking and heating fuel, sugar and bread, are causing grim hardship. The UN's World Food Programme reckons that 2m or so of the 10m-odd people still in Zimbabwe (some 3m have emigrated) urgently need food handouts. That number could swell to 5m by early next year, after the failure of this year's harvest.

The European Union and the United States are waiting to see how the new government, still to be formed, will function before piling in with every kind of aid, though food will be an early priority. Their list of targeted sanctions that ban travel for 130 or so of Mr Mugabe's closest political and business comrades and freeze their overseas assets will stay in force until standards of government visibly improve. Foreign investors, keen to get back into what was once one of southern Africa's most vibrant economies, are poised to return but many will wait for the reversal of recent laws decreeing that the government may prevent any foreign concern—and any white Zimbabwean—from owning more than half of any company.

Waiting for manna

Few outsiders will offer hard cash until economic policy clearly changes direction. If that happens, the International Monetary Fund says it is ready to discuss ways to steady the economy. At the end of August, Zimbabwe still owed $137m to the Fund, which has not lent money to Mr Mugabe's government since the 1990s.

Above all, outsiders will want to see whether Mr Mugabe's team still pulls the main levers of power. If they do, Zimbabwe will continue to sink without much help from abroad. The more Mr Tsvangirai manages to deliver, the faster the world will come to the country's aid. But it could be months more agony before it becomes clear which way Zimbabwe is going.

South Africa

The presidency of Jacob Zuma looms

Sep 18th 2008 | JOHANNESBURG
From The Economist print edition

A court decision that paves the way for a new national leader

Reuters

FOLLOWING threats of chaos if their champion went on trial, Jacob Zuma's backers are making celebratory noises. On September 12th, a court declared that the charges against the president of the ruling African National Congress (ANC), including corruption and fraud, were invalid because the correct procedure had not been followed. The judge went on to say that accusations that President Thabo Mbeki and some of his ministers had unduly influenced the prosecution in the case against Mr Zuma were plausible. Though there was little chance of Mr Zuma facing trial ahead of elections next year, striking out the charges would decisively clear the way for him to become South Africa's next president. It is Mr Mbeki, the bitter rival from whom Mr Zuma wrested the ANC's presidency last December, whose political survival is now at stake.

The court's decision, which dealt only with procedure, has no bearing on whether Mr Zuma is guilty or innocent of the shenanigans related to arms procurement dating back to the 1990s. Within days of the ruling, the National Prosecuting Authority (NPA) said it would appeal against it. The ANC then called the NPA's decision "cynical and ill-considered". The parliamentary opposition, however, has applauded the NPA's latest move, saying Mr Zuma has a case to answer. If the NPA loses its appeal, it could in theory, provided it follows the rules this time, charge Mr Zuma again.

Whatever it decides to do, the NPA is in a jam. It was already the second time it had botched the case. Another court struck the charges off the roll two years ago when it became clear that the prosecution, after five years of investigation and after the conviction of Mr Zuma's financial adviser for corruption in the same affair, was not ready to proceed. With the judge arguing that Mr Mbeki may have used inappropriate influence on the NPA, the prosecution will struggle to look independent if it charges the ANC president yet again. But it could look as if it had buckled under pressure from Mr Zuma's supporters, who launched ferocious verbal attacks on the judiciary ahead of the ruling, if it does not.

This may become moot in November, when a court will consider whether to put a final end to charges against Mr Zuma. In any event, he says he cannot be guaranteed a fair trial because the courts are biased—though last week's ruling, as well as his acquittal on rape charges in 2006, indicates otherwise.

Some of Mr Zuma's staunch allies, including the ANC Youth League, are smelling blood and asking for the head of Mr Mbeki. The court ruling prompted calls for him to step down ahead of the general election next summer, and even for his ANC membership to be rescinded. But he may survive until the election, when a new parliament will elect his successor. Mr Zuma says it would be a waste of energy to beat a "dead snake" and that the ANC must rebuild unity. In any event, its new leadership team, elected last December, may not yet be ready to take over the reins of government. A premature and chaotic transition could hurt the party in next year's general election, even though it is certain to win. The ANC leadership was to meet on September 19th to discuss Mr Mbeki's fate.

Whatever the outcome, there will be much unfinished legal business. Unless Mr Zuma answers the accusations against him in court, a cloud of suspicion is sure to linger over him, to the detriment of his future presidency. If he ever ends up standing in the dock, it will almost certainly be after he is elected president. Last week the judge suggested that an independent commission of inquiry be appointed to scrutinise the arms deal, which many suspect was riddled with corruption, "to rid our land of this cancer that is devouring the body politic and the reputation for integrity built up so assiduously after the fall of apartheid." For years opposition parties have been demanding that the investigation be reopened, to no avail.

The judge's suspicions of "baleful political interference" with the NPA are feeding worries about the judiciary's independence. But attacks on the courts by Mr Zuma's allies, as well as their dogged determination to dissolve the NPA's anti-corruption unit known as the Scorpions, suggest they may respect the independence of the courts and prosecutors only as long as these produce decisions they like.

Nigeria

Risky toughness

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The army's tough approach to Delta militants could end up uniting them

Reuters



River bandits or freedom-fighters?

ARE battles between Nigeria's armed forces and militants in the Niger Delta pushing the country closer to catastrophe? The militants claim that Nigeria is "gradually heading towards an abyss of civil war." John Odey, Nigeria's minister of information, replies flatly: "There is no war and to describe it as a war is not accurate." But the government's new tough approach may have the dangerous effect of uniting the various armed gangs that oppose it in the oil-rich region.

In the early hours of September 13th the armed forces launched an air-and-sea attack on a militant camp in the Niger Delta. This led the region's most prominent armed group, the Movement for the Emancipation of the Niger Delta (MEND), to hit back, both at the army and at oil installations. It declared an "oil war", raising for the first time the spectre of a wider conflict.

MEND portrays itself as political organisation that wants a greater share of Nigeria's oil revenues to go to the impoverished region that sits atop the oil. In fact, it is more of an umbrella organisation for several armed groups, which it sometimes pays in cash or guns to launch attacks. This franchise approach has so far been successful. In three years the group's orchestrated attacks across the Niger Delta have reduced the country's oil output by a fifth. The latest estimate is that civil strife may now be losing Nigeria 40% of its output.

Until recently the militants have tried to avoid a direct fight with the security forces. But this time, after the attack on one of their camps, fighters from various groups sought out and engaged the army in combat. A once disparate array of fighters, often with their own competing agendas, the militant groups are beginning to look more unified.

Gang leaders who previously distanced themselves from MEND are aligning themselves with it. One of them is Ateke Tom, a gin-swilling bandit whose recent attack on the army was launched under the MEND banner. Patrick Naagbanton, a human-rights campaigner based in Port Harcourt, the region's biggest city, sees Mr Tom's realignment as a worrying portent. "There seems to be a creeping solidarity", he says, "as they all stand up to the force of the military." Another MEND leader agrees: "When it comes to a common enemy, we all help each other," he said. "The army isn't as formidable as they say, and we're ready to take it on."

President Umaru Yar'Adua has made calming the oil region a priority but he has moved slowly. He has recently created a dedicated Ministry for the Niger Delta to oversee development, and convened a 40-strong committee to look for long-term solutions. He also replaced senior commanders in the armed

forces just days before the recent big attack, suggesting that a tougher approach had been decided on.

Complicating matters, some army officers, as well as state-level officials, are accused of being in cahoots with the gangs, sharing the proceeds of oil thievery and other criminal ventures. Gun-running is believed to be a big source of MEND's revenue, as is the oil siphoned from pipelines and sold to refineries overseas. Insiders in the oil industry reckon that as much as 10% of Nigeria's oil production, worth millions of dollars, is stolen each day. One fear is that a military drive against the militants could split apart the shared monetary goals that have helped to keep the region from spiralling into all-out conflict.

The government is eager to dispel notions of civil war, a particularly sensitive subject since the Niger Delta lies at the heart of the territory that tried to secede from Nigeria in the Biafran civil war in the 1960s. "This is a state of anarchy, a state of violence and insecurity—I really can't talk about a civil war," says Dimieari Von Kemedi, a member of government in Bayelsa, one of the Delta states. Bayelsa, which has its fair share of armed gangs, has remained calm through the recent battles. Mr Von Kemedi puts this down to his state's decision to pay the militants in order to encourage them not to steal or attack pipelines. "It's not a very neat solution, but what are the options?" he asks.

Saudi Arabia

Death to the media moguls!

Sep 18th 2008 | CAIRO
From The Economist print edition

The abiding puritanism of some senior Saudi sheikhs

IN MOST countries, incitement to murder is a crime. But in Saudi Arabia, encouraging people to kill is a special privilege reserved for those whose job it is to uphold the law. At least, this appeared to be the case when the kingdom's chief justice, Sheikh Saleh Luhaidan, speaking on a live radio programme, answered a caller's question about the broadcast of "lewd" television shows during the holy month of Ramadan. The 79-year-old religious scholar described the owners of some satellite channels as "apostles of depravity", and said it would be lawful to kill them.

Understandably, those words from the head of the Supreme Judicial Council, Saudi Arabia's highest court of appeal, sparked an uproar. Not only Saudi liberals but prominent rival sheikhs condemned the ruling as an example of the ideological extremism that has encouraged violent radicals. In response, Mr Luhaidan qualified his words. He did not mean to imply that anyone should just go out and murder broadcasters, said the bearded sheikh in a subsequent interview on state television. Such people should only be killed after being tried in a Saudi court and only after being given a chance to mend their ways.

Saudis are used to chilling pronouncements from the country's 700 religious judges, all of whom are schooled in the puritanical Wahhabist interpretation of Islam. The kingdom's most senior religious authority, the Grand Mufti, Sheikh Abdul Aziz al-Sheikh, recently scolded a fellow scholar for suggesting that celebrating birthdays was a harmless thing to do, declaring instead that such festivities are sinfully unIslamic. He also blasted a Turkish television serial, whose dramatisation of intrigue and romance among the rich and unveiled Muslims of cosmopolitan Istanbul had attracted record audiences this summer, as subversive to the faith.

Clerical challenges to television content are hardly surprising in a country where religious scholars gave their assent to broadcasting only in 1965, after being shown that Koran recitation and Wahhabist sermons could be beamed through the air too. Many Saudis agree that the fare on satellite television, especially during Ramadan, is unnecessarily racy. Yet many admit that, given bans on other forms of entertainment, there is not much else to do.

What made Mr Luhaidan's outburst particularly piquant is that the owners of most of the channels that Saudis watch are, in fact, fellow Saudis, some of them with close ties to the ruling family. The chief shareholder of MBC, the region's most popular entertainment network, boasting some 80m regular viewers, is a brother-in-law of the late King Fahd. Prince Waleed bin Talal, a prominent financier and the current king's nephew, owns the Rotana network, best known for video clips featuring buxom Lebanese pop tarts. Saudi regulators cannot touch these channels, because they are based outside the kingdom, in more open-minded Dubai. But the authorities have taken disciplinary action. They have abruptly taken the long-running live radio show that featured Mr Luhaidan off the air.

Israel

Tzipi Livni bids for the top spot

Sep 18th 2008 | JERUSALEM
From The Economist print edition

Will the new leader of Israel's ruling party become prime minister?

Clarification to this article

AS EXPECTED, Tzipi Livni won the leadership of Israel's ruling Kadima party in a primary election on September 17th. But, confounding the opinion polls and pundits, she won by only a whisker. The narrowness of her victory will make it harder for her to put together a new government, or, if that fails, to lead her party into a general election. She still has quite a way to go before becoming Israel's second woman prime minister.

AP



The lady packs a punch

Ehud Olmert, the previous Kadima head who has been entangled in corruption inquiries, will formally resign as prime minister with a statement to the cabinet on September 22nd. Israel's president, Shimon Peres, after a round of consultations, will then ask Ms Livni to form a government, which she has up to six weeks to accomplish. Failing that, a general election must take place within another three months, followed by further coalition-making efforts by whoever wins it. A lot of haggling, then.

Mr Olmert will stay on all this time as transitional prime minister, bereft, by constitutional convention, of the power to make big new decisions. So peace talks with the Palestinians, which have been stumbling forward under Mr Olmert, will probably be put into abeyance for weeks, perhaps months.

Ms Livni says she wants a quick decision one way or the other by her prospective partners. "It's up to them," she says of the Labour Party and Shas, the Orthodox-Sephardic one, who are both in the present ruling coalition. But Shas says it will be up to her. It wants her to reopen the state budget for 2009 and sharply to raise child-welfare allowances. Ronnie Bar-On, the finance minister, a senior backer of Ms Livni in the Kadima contest, says the global financial upheaval is reason enough to reject Shas's demand.

That would have been easier had Ms Livni's position inside her own party been stronger. She emerged with 43% of the vote, just 1% ahead of her main rival, Shaul Mofaz, the transport minister. She has been flirting with the doveish Meretz party, in the hope of bringing it into the coalition—or at least holding that prospect over Shas's head. The harder-line Mr Mofaz, a hawkish former chief of staff of the army, was against an alliance with Meretz. Following his defeat, he now says he wants to take a break from politics. But his supporters will be clamouring for Ms Livni not to "go soft"—and they are plainly still a powerful constituency in her party.

Clarification: Since our print edition went to bed, Mr Mofaz announced his intention to step down from politics for the time being. The final paragraph of this article was changed accordingly on September 18th 2008.

Russia's armed forces

Advancing, blindly

Sep 18th 2008
From The Economist print edition

A more aggressive Russian army is still no match for NATO, but is strong enough to scare some neighbours

AFP



Get article background

WHEN Russian armoured columns rumbled into Georgia last month, an early casualty was General Anatoly Khrulyov, the head of the 58th Army, who was wounded by shrapnel and evacuated. The Russians lost their most senior commander in the field because, by their own accounts, they did not know where Georgian units were. Russian forces lacked surveillance drones and night-vision equipment. Radios worked poorly, and commanders resorted to using mobile phones. Troops barely co-ordinated with the air force, which lost several jets (among them a Tu-22 strategic bomber) and dropped mostly old "dumb" bombs rather than modern smart ones. The wonder is how the Russians routed the Georgians so swiftly.

The Kremlin had been displaying a new military assertiveness even before its "August war" with Georgia, sending cold-war bombers buzzing close to European and American airspace, holding high-profile naval exercises, announcing ambitious plans to build new aircraft carriers and testing new ballistic missiles. What Vladimir Putin, Russia's prime minister, has called a "punch in the face" for Georgia may have been an attempt to demonstrate the restoration of Russia's military power. But it also exposed the poor results from Russia's recent surge in defence spending.

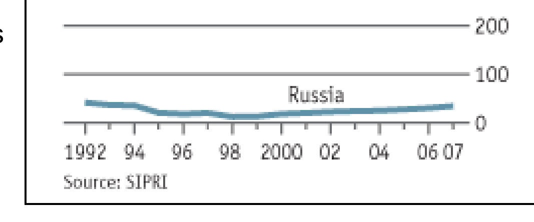
This has doubled in nominal rouble terms since 2004. Yet much of the extra money has been eaten away by inflation. In any case, Russia's defence spending is a fraction of America's (see chart).

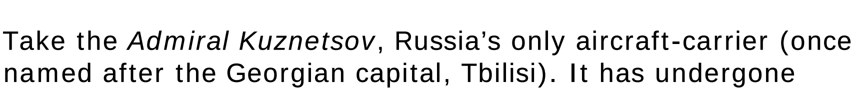
Russian commanders have spoken bluntly about shortcomings. President Dmitry Medvedev says that reforming and re-equipping the armed forces will be a top priority. On September 16th, Mr Putin announced a 27% increase in spending next year on "national defence and security".

Yet much of that money goes on maintaining Russia's nuclear deterrent. During the cold war it was the West that relied on nuclear weapons to offset the Soviet Union's conventional superiority; now it is the other way around. Although in better

shape than the rest of Russia's military units, the nuclear forces have not escaped the post-Soviet rot. The first of its new Borey-class nuclear submarines launched last year is useless because its planned intercontinental ballistic missile, the Bulava, designed to outwit anti-missile defences, has been plagued by test failures (Western officials say it has problems with its range too).

Outside experts estimate that one-third of defence spending is embezzled or otherwise mis-spent. Anatoly Serdyukov, the defence minister, has tried to curb corruption among the top brass. Yet Alexander Golts, a Moscow-based defence expert, says "the Russian army is a black hole" into which money simply disappears. The result is a military fantasy in which Russia sends barely functional bombers and warships on long-range missions.





Take the *Admiral Kuznetsov*, Russia's only aircraft-carrier (once named after the Georgian capital, Tbilisi). It has undergone interminable repairs since being commissioned in 1985. It took part in rare exercises in the Atlantic and the Mediterranean between December 2007 and February this year. In the view of Western experts, the Russians did well simply to avoid its breaking down. Russia's announcement in July that it will build five or six more aircraft carriers has been met with derision. Russia does not have shipyards able to build such vessels; the *Admiral Kuznetsov* was built in a shipyard that is now in Ukraine.

That said, Russia makes some good equipment, such as air-defence systems. The infusion of money helps it exercise its atrophied military muscles. A growing proportion of soldiers are volunteers (known as *kontraktniki*), who are more disciplined than much-abused conscripts. The slow move to a smaller, all-professional army in place of the million-strong, largely conscript force is made more urgent by Russia's demographic decline.

The forces that invaded Georgia were largely made up of professionals. Despite problems in keeping them supplied, they were for the most part better behaved than the South Ossetian militiamen who looted and destroyed Georgian villages. The Russian army seems to have fought better in Georgia than it did in either of the post-Soviet wars in Chechnya, the now-subdued breakaway province across the border from Georgia. Indeed, the forces sent into Georgia included the Vostok battalion, made up of pro-Kremlin Chechens. Russia's ability quickly to deploy 20,000-odd soldiers in Georgia (rehearsed in exercises during the summer) showed some skill.

"Russian forces are not modern. Some of their weapons date back to the 1960s and 1970s. But that does not mean they cannot kill you," says Pavel Felgenhauer, a Russian defence writer for *Novaya Gazeta*, a newspaper. The Russians may not be a match for even a medium-sized Western army, say experts, but they are good enough to scare the poor, post-Soviet states in the "near abroad".

In the words of a senior American official, "the war in Georgia does not show the Russians have greater military capability, but it demonstrates a greater willingness to use force." NATO will have to reassess its assumptions about Russia, albeit cautiously to "avoid creating a self-fulfilling prophecy", as the official puts it.

The main threats to the West now are Russia's manipulation of oil and gas exports, its diplomatic spoiling tactics, and its dalliances with Iran, Syria and Venezuela. The danger of a direct attack by Russia is remote. But the indirect threat of its more advanced weapons being sold to such potential Western foes is a growing worry.

Russia and its neighbours

Bang, crash

Sep 18th 2008
From The Economist print edition

What Russia's stockmarket collapse means for Russia and for its neighbours

EVER since Vladimir Putin and his ex-KGB friends came to power in Russia, they have had one big advantage: a booming economy, rising prices for oil and gas exports, and strong capital inflows from abroad. All of a sudden, that has changed.

Partly as a result of the storm hitting all emerging markets (see article) and partly because of jumpy nerves following the war with Georgia, the markets in Moscow have been crashing. On September 17th and 18th the authorities halted trading in shares and bonds after the benchmark RTS share index fell 21% earlier in the week. It is down nearly 60% since its peak in May. The finance ministry pledged $60 billion to prop up the banking system; much of it seems to have gone offshore.

As regulators and politicians in Moscow struggle to contain the damage, and firms worry about bonds due later this year, a big question is how the economic turmoil will affect Russian politics at home and its policies abroad. Optimists hope the market wobbles will mean a less abrasive anti-Western foreign policy and the restarting of reforms. Others fear that the Kremlin will respond with tighter controls at home and a still tougher stance abroad.

Modernising reforms largely stopped in the final years of Mr Putin's presidency, as the Kremlin sought to control the country's oil and gas industry, and to silence critics. His successor, Dmitry Medvedev, made promising speeches on corruption and legal reform, but has not acted on them. Andrei Piontkovsky, a sharp-tongued Russian commentator, says the struggle among Kremlin clans is between "global kleptocrats" who want to be part of the world economy and "national kleptocrats" with cruder domestic interests.

For now, Russia shows no sign of softening on Georgia. It has said international monitors cannot operate in South Ossetia (whose independence is recognised only by Russia and Nicaragua) without permission of authorities there. It insists that South Ossetia, and the other breakaway region, Abkhazia, must participate in upcoming talks in Geneva on settling the conflict. Georgia says it will not attend if the separatists are there.

Russia has also accused NATO of showing "cold war reflexes" after a visit to Georgia by the alliance's secretary-general, Jaap de Hoop Scheffer. He said that Georgia's "road to NATO remained wide open", without giving specifics.

Ukraine, meanwhile, faces not only a financial crisis but also a political one exacerbated by the war in Georgia. The governing coalition has collapsed after a row between Viktor Yushchenko, the president, and his former ally, Yulia Tymoshenko, the prime minister. Her party is moving towards an alliance with the grouping led by Viktor Yanukovich, once the Kremlin-backed candidate who was blocked from the presidency by the pro-democracy "orange revolution" of 2004.

Mr Yushchenko says Mrs Tymoshenko is selling out to Moscow; she says he has dangerously inflamed relations with Russia. Some fear that the Kremlin is exploiting Ukraine's political weaknesses. But the country's politicians seem to be doing enough damage without outside help.

Serbia

A new strongman

Sep 18th 2008
From The Economist print edition

The Serbian president has become unusually powerful

Get article background

WITH bombers streaking overhead during a military passing-out ceremony in Belgrade on September 13th, there was no mistaking the expression of satisfaction on the face of Boris Tadic, Serbia's president. It looked more like his victory parade. Just two months after struggling to put together a European-leaning government in July, Mr Tadic now stands as the undisputed master of his country.

This is because the largest Serbian opposition group, the ultranationalist Radical Party, has imploded thanks to an internal war between the devotees of Vojislav Seselj, currently standing trial for war crimes at the United Nations' tribunal in The Hague, and the allies of the more pragmatic Tomislav Nikolic, who led the party within Serbia.

The split became apparent on September 2nd, when two Radical women deputies issued blood-curdling curses in parliament. They accused Mr Tadic of being "a traitor" because his government had arrested Radovan Karadzic, the former Bosnian Serb president, and sent him to stand trial in The Hague. Nothing unusual here. But then one of them, Vjerica Radeta, shouted something odd: "A curse on every Radical, on his seed and family, who ever meets with Tadic after the shameful extradition."

Soon her meaning became clear: Mr Nikolic had been secretly meeting Mr Tadic to strike a deal to ratify a key agreement with the EU that the Radicals had hitherto opposed. Mr Nikolic announced that the agreement was good for Serbia. This raised the ire of Mr Seselj, who from his prison cell urged deputies to vote against the accord.

As a result the Radical party has fallen apart. Mr Nikolic has been expelled with 17 of his supporters and is setting up his own party. Mr Tadic is thus freer to pursue his rapprochement with the EU. "On the one hand this is the best thing that could have happened to Serbia because the Radicals are divided into pro- and anti-European wings," says Zoran Lucic, a top Serbian pollster, "But on the other I am afraid that for some time we will have an effective one-party system." And that party, of course, is Mr Tadic's.

Not everything is going his way. On September 15th the Netherlands blocked an EU trade agreement with Serbia, saying it must first find and extradite Ratko Mladic, the former Bosnian Serb military commander. Now that Mr Tadic is all-powerful, that may be easier to do.




Less than white?

Sep 18th 2008 | ANKARA
From The Economist print edition

A growing row over claims of government corruption

LEADERS of Turkey's ruling Justice and Development (AK) party like to boast that their acronym means "white" or "clean" in Turkish. No longer so. A succession of corruption allegations is sullying AK's image of probity.

Much mud is being flung over a scandal involving a Turkish charity, Deniz Feneri ("Lighthouse" in Turkish). On September 17th a German court convicted three Turkish men involved in the charity of siphoning off €18.6m ($26m). The money had been raised ostensibly to help needy Muslims, among them Palestinians, Turkish slum-dwellers and refugees in Pakistan. Instead the court found that some funds went to buy real estate in Turkey.

Opponents of the Turkish prime minister, Recep Tayyip Erdogan, claim that some money was funnelled to Kanal 7, an Istanbul-based television channel with close ties to the government. The court, however, found no evidence of links to AK.

Mr Erdogan has turned his ire on Aydin Dogan, the owner of Turkey's biggest media conglomerate, whose newspapers and television channels have led the way in reporting the Lighthouse scandal. Mr Erdogan claims the media group is stirring up the controversy because AK refused to grant Mr Dogan favours for his other business interests, including a permit to build luxury residences on land around Istanbul's Hilton hotel. The prime minister has denounced Mr Dogan's journalists as "dishonourable" and "lowly sell-outs". Such has been his vehemence that one bemused European ambassador wondered: "Might it be that Ramadan fasting has weakened his nerves?"

The Dogan group has in the past been accused of using its media muscle for commercial advantage. Moreover, some Dogan titles, notably the flagship daily, *Hürriyet*, had been among the biggest cheerleaders of the secularists' political campaign against AK. In July the party narrowly avoided a ban for breaching constitutional rules against Islamism.

Now some claims of corruption are beginning to stick. Earlier this month an AK deputy, Saban Disli, resigned from a top party post after being accused of receiving a million-dollar kickback from a land developer. "This is just the tip of the iceberg," asserts Yilmaz Ates, a deputy for the main opposition Republican People's Party, which unearthed the deal.

Ali Bulac, a prominent Islamist intellectual, says the Lighthouse scandal has "triggered trauma" among Mr Erdogan's core of pious supporters. Matters have not been helped by his attempts to promote Mr Dogan's rivals. These include Calik Holding, which recently acquired Turkey's second largest media group, Sabah-ATV, thanks to generous loans from a state-owned bank. Mr Erdogan's 29-year-old son-in-law is Calik's chief executive.

Despite the uproar, opinion polls suggest that Mr Erdogan's popularity far outstrips that of his rivals, with around 50% of the vote. Meanwhile, shares in Dogan Holding have fallen sharply as investors worry that the row with the government could damage its $8 billion empire.




Muslim extremism in France

Jailhouse jihad

Sep 18th 2008
From The Economist print edition

Fears that terrorism is breeding in French prisons

HOME to Europe's biggest Muslim population and a robust counter-terrorism system, France has long kept a keen watch on Islamic radicalism. In recent years it has been spared big bombings of the kind seen in London and Madrid. But France is no stranger to attack by jihadists, and officials fear it is just a matter of time before they strike again.

The authorities are particularly worried about recruitment to militant Islam in France's overcrowded prisons. "French prisons are a preferred recruiting ground for radical Islamists," Michèle Alliot-Marie, the interior minister, told *Le Figaro* newspaper. She and her EU counterparts have been working on a joint handbook on how to counter the phenomenon, which touches many European countries, notably Britain. At the end of September, Ms Alliot-Marie will host an EU seminar, in the heavily Muslim Paris *banlieue* of Saint-Denis, to discuss what to do.

Fiercely secular, France does not collect official statistics based on religion. But Farhad Khosrokhavar, a French specialist on the subject, estimates that Muslims make up well over half France's prison population—far higher than their 8% or so share of the total population. Among these there are currently some 1,100 people behind bars in France for terrorist-related activities, according to Alain Bauer, a criminologist. Ms Alliot-Marie said that another 55 have been detained this year.

Proselytising among inmates is common. Security officials are worried that many radicals jailed around the time of the 1998 football World Cup, hosted by France, are starting to be released. "Radicalised Islamists become more influential in prison," says Mr Khosrokhavar. He reckons there are a few hundred Islamists actively recruiting behind bars in France.

It is hard to know how to counter this. Concentrating jihadists in one or two penitentiaries, as many countries do, may help them plot attacks from prison. Yet dispersing them, or regularly moving them between high-security prisons in order to disrupt networks, may spread radical ideology and increase recruitment.

Less crowded cells might help. France, whose jail population has grown by 30% since 2001, is building three new prisons to this end. Another idea is to provide more Muslim chaplains to offer a moderate spiritual outlet for Muslim inmates.

Azzedine Gaci, head of the Regional Council of the Muslim Faith in Lyon, makes such visits to the prison in Villefranche-sur-Saône, where he reckons 70% of its 700-odd inmates are Muslim. "They need a different interlocutor," he says. In the absence of competent chaplains, extremists fill the vacuum. France currently has 1,100 chaplains accredited to visit its 63,000 inmates across 195 prisons—yet only 117 of them are Muslim.

Charlemagne

Who cares about Europe?

Sep 18th 2008
From The Economist print edition

Voters don't know much about the European Union. What's more, they don't want to learn

Illustration by Peter Schrank



TELLING lies in politics is dangerous, but sometimes the truth is worse. Ask Charlie McCreevy, the European Commissioner who oversees the internal market. Shortly before last June's referendum on the Lisbon Treaty in his home country, Ireland, he told voters that no "sane or sensible person" would read its full text. His remark backfired horribly; many voters thought they had heard him admit that he did not know what was in the treaty.

There is something in what he said. Insanity is a harsh term, but you would not want a dinner-party guest who reads European Union treaties for fun. Much of the EU's business may be important, but it is baffling to outsiders—and very dull.

People in Brussels rarely admit this, but the off-putting complexity of the EU has big political consequences. Proof may be found in research just released by the Irish government, examining why voters rejected the Lisbon treaty. Pro-Europeans have seized on the ignorance of "no" voters: for example, half of them believed the (false) claims of anti-Lisbon campaigners that the treaty would introduce conscription into a European army. But many overlooked a second finding, that "yes" voters were equally confused. Only 18% of those who supported Lisbon said they had a "good understanding" of the treaty. To quote the researchers: the pro-Lisbon vote "was largely a pro-Europe vote", not an endorsement of the treaty's merits.

As Ireland is pressed to hold a new referendum on Lisbon (and to get the answer right this time), the government there has talked about the need to explain the treaty and the EU better. Yet that is undermined by the most significant finding of all in the Irish research: most voters have a limited appetite for information about the EU. A "vast majority" of focus group members—whether they backed Lisbon or not—had no idea how decisions are taken in the union. "Few" thought that, realistically, they would bother to learn more.

This is the key message of the Irish vote. The public does not want to understand the fiendish complexity of the EU. Many in the EU establishment draw a simple conclusion from that: never ask voters directly about something as complicated as a treaty.

They know that many other governments would have lost referendums if they had dared to hold them (instead, the 26 other countries all chose the safer path of ratifying the treaty through national parliaments). The EU establishment takes comfort in the fact that—like Irish "yes" voters—a broad majority of EU citizens have a fuzzy sense that the project is a good thing, even if they have little idea

how it works. To many Eurocrats, voter indifference is something to be managed, rather than feared. National health policies are as complex as EU treaties, argues a diplomat, and voters do not expect to understand every detail of how health systems work. This is a tempting argument. But in the longer term, EU leaders are dodging a fundamental question: do you need to seek voters' informed consent for the European project?

The answer must surely be yes. The EU is no longer just a free-trade zone. With the advent of things like EU immigration policies, or extraditions without appeal within the union (via the European arrest warrant), the EU now touches the essential contract between the citizen and the state. Yet the Irish research confirms that the EU is too complex for non-specialists to understand the changes under way.

How, then, can the EU obtain consent? Two answers suggest themselves, both seemingly rather extreme. One involves much more federalism; the other is a strict commitment to keeping the EU as an intergovernmental club, in which national parliaments and national governments are dominant.

It is to their credit that federalists do not think voter indifference to the EU can be ignored. Many say, at least in private, that the EU needs more democratic legitimacy. They worry about the fact that voter turnout has fallen at each European Parliament election since 1979, to 45% last time. They argue that voters must be woken up to the importance of the EU by injecting partisan debate into European politics. In a provocative 2006 book, Vivien Schmidt, a federalist-minded academic from Boston University, called for national politicians to be more honest about how much power has already passed to the EU, rather than "speaking as if they fully retained their former authority". Others advocate Europe-wide referendums on a single day to pass new treaties, which would be approved by a majority of voters in a majority of countries. Many talk about the need for pan-European political parties, or a bigger EU budget funded by Euro-taxes.

Federalist fantasy

Such federalist proposals are intellectually coherent—and politically doomed. There is no European *demos* and, across 27 member-states, there will never be. For example, centre-right parties in France are far warier of free trade than the Swedish centre-left. When it comes to views of America or Russia, mainstream voters in Greece or Cyprus have little in common with mainstream voters in Poland or Britain. Passing treaties by pan-European majority votes would be a swift way to break up the EU; what country could tolerate having a treaty imposed on it, if its own citizens had rejected it by a clear margin?

Ireland shows that most voters do not understand the EU, and do not really want to. What they do understand is national politics, and care about who wins national elections. So the only coherent answer to disenchantment with the EU lies in preserving a leading role for national governments and parliaments.

That is not all roses—national politicians are to blame for some of the EU's worst failures (such as fisheries). But the EU's best hope of enjoying democratic support for its extravagantly complex workings is a devolved form of consent, channelled through national representatives.

Anything else is neither sane, nor sensible.

Economist.com 

University education

Making it pay

Sep 18th 2008
From The Economist print edition

Is a university degree still worth the time and money it takes?

The Guardian



Get article background

“MORE will mean worse,” wrote an angry Kingsley Amis in 1961, contemplating plans to expand university education. His prediction has been tested past anything he could have imagined, as that era’s new universities were joined by the ex-polytechnics in the 1990s, and the proportion of youngsters who go on to university rose from less than 10% to almost 40% now. The 430,000 new undergraduates heading off to freshers’ weeks later this month will find themselves part of Britain’s largest university cohort ever.

Similar rumblings have continued since Amis’s jeremiad. With less government money (in real terms) per student than in his day, universities have to pack them in and keep them in to balance the books. Paul Buckland, an archaeology professor at Bournemouth University, resigned when administrators overruled his failing grades for ten students (last month he won a case for “constructive dismissal”). In June a barnstorming lecture by Geoffrey Alderman, of Buckingham University, gained wide attention with its claims of impotent external examiners, widespread unpunished plagiarism and a “grotesque bidding game” in which universities dished out good grades in order to claw their way up league tables.

Mr Alderman’s complaints opened the floodgates; disgruntled academics spilt their hearts out in internet chat rooms—and to the committee of MPs charged with overseeing universities. So worried is the committee that it is considering an inquiry into standards. Some think it should have turned a blind eye: “We have been told that simply by looking at this question we are bringing this country’s universities into disrepute,” says Phil Willis, its chairman.

Some of this is standard fare: American universities suffer periodic spasms over grade inflation; plagiarism is on the rise wherever students can use the internet. But British universities are particularly vulnerable to any loss of reputation. Only America, five times its size, has more foreign students, and with fees for local students capped, Britain’s universities break even only by charging overseas ones what the market will bear. Figures published on September 16th showed that for most, this source of income is now more valuable than government funding for research.

In trying to maintain standards, English universities face a particular problem (the Scottish system is different). Their standard short, specialised degrees suit only the well prepared: in three years there is no time for a ruthless weeding-out after one year, as is common elsewhere in Europe, or for a broad

education before choosing a major subject, as in America. But the A-levels which used to provide that preparation have changed into a school-leaving qualification, and universities have had to nip and tuck what they teach accordingly.

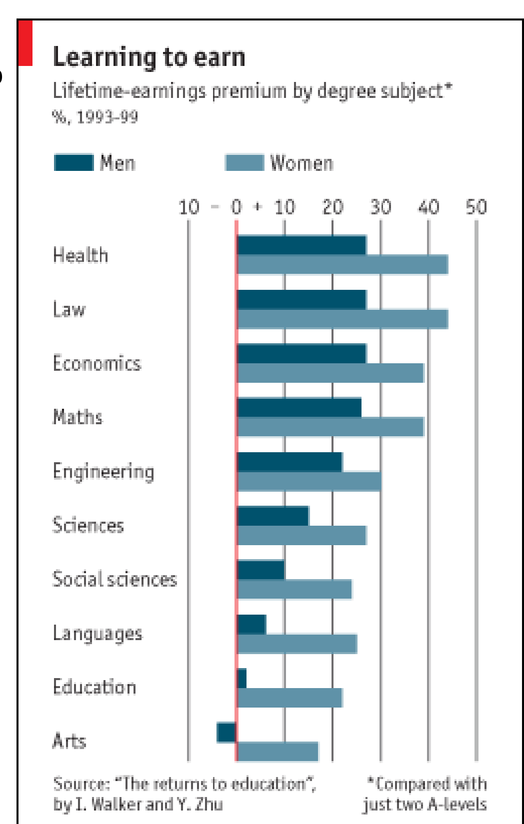
A system predicated on achievement, not potential, is under further pressure from a government that wants universities to admit more children from state schools, many of which offer a sketchy academic education. Sometimes the strain shows. On September 10th Alison Richard, Cambridge University's vice-chancellor, said that her institution's core mission was "to provide an outstanding education within a research setting", not to promote social mobility. Obvious enough, perhaps, but John Denham, the secretary of state for universities, said he profoundly disagreed.

Absent better state secondary schools, universities may have to take radical measures: Cambridge is considering a foundation year for students who show potential but are ill prepared. A review of the government-imposed cap on tuition fees, due next year, may also help. The current limit of £3,300 ($5,926), which nearly all universities are up against, is so low that many lose money on teaching. A higher cap would allow greater differentiation, thus helping to remove another flaw: the pretence that a degree of a particular class (a first, say) from one university is equivalent to the same class from any other.

So all is not lost—yet—in the battle for quality in what will be on offer to future freshers. But "more" could still mean "worse" if the jobs market is flooded with graduates. The Confederation of British Industry worries this is the case: on September 17th it launched a task-force to consider not only whether the wrong sort of graduates are being turned out but also whether supply risks outstripping demand.

This is likely to be what concerns students most. A survey released on September 11th by Sodexo, an education-outsourcing company, found that for more than half of them the prime reason for pursuing a degree was to improve job or salary prospects, or that they had to for their chosen profession. Only 9% wanted to increase their knowledge of an area of interest.

At first glance, the earnings uplift looks worthwhile. An estimate in 2006 suggested that in purely financial terms a degree produced the same lifetime-income stream as giving an 18-year-old with two A-levels £160,000 to invest. But cracks are appearing in the "graduate premium". For one thing, it varies immensely by field of study (see chart): men with arts degrees can expect to earn less than if they had skipped university entirely. (The relative returns for graduate women are higher not because they earn more than men but because less-qualified women earn very little.) For another, its value is increasingly dependent on the detail.



Robin Naylor, at Warwick University, has found that the average return to a degree has held up well over the past 20 years, but it has become more variable: the university now matters greatly, as does the degree class. "The penalty for not having a degree is high, but the penalty for getting the wrong one can be even higher," he says. And Francis Green, of Kent University, has discovered that in 2006 a third of graduates were working in jobs that did not require a degree, up from a quarter in 2001; they earned a third less than those who were using their degrees.

It is too late for this year's freshers to reconsider their university careers; but what should next year's batch do? Those who are in it for the money should be ruthless about what they study and where—and then be sure to work hard and get good marks. Or they could throw away the calculator and follow their hearts. "It's a big risk, going to university, much bigger than it used to be," says Mr Naylor. "But if you study something you like, then even if you don't earn so much, there is a better chance you'll work in a field you love."

Race and the police

No quick fix

Sep 18th 2008
From The Economist print edition

An ugly public row sees London's police force accused of being racist. Is it?

WHEN he was posted to the London borough of Lewisham in April 1973, David Michael was the first black constable ever to walk the beat there. "It was a different time," he says. "The police were like an occupying army." Relations between coppers and the community have been transformed since then, he reckons. But claims of racism inside London's Metropolitan Police have led some to wonder. So far this year five senior non-white officers have brought, or are reportedly preparing, claims of racial discrimination against the Met (to date, one has been won and another lost). "I'm very disappointed," says Mr Michael, who helped to found the Black Police Association and for three years chaired it before his retirement. "But not totally surprised."

Is the Met racist? It certainly used to be. A 1999 report into matters arising from the death of Stephen Lawrence, a black teenager stabbed to death in 1993, concluded that the force's mishandling of the case betrayed "institutional racism". But many thought things had changed. The Met's current commissioner, Sir Ian Blair, has presided over some disasters (see article) but his credentials on race look good. After a spell in charge of diversity at the Met, Sir Ian became commissioner and caused a stink by musing that a murder case was attracting media attention because the victims were white. He still enjoys the support of Ken Livingstone, London's former mayor, who revels in all things multicultural.

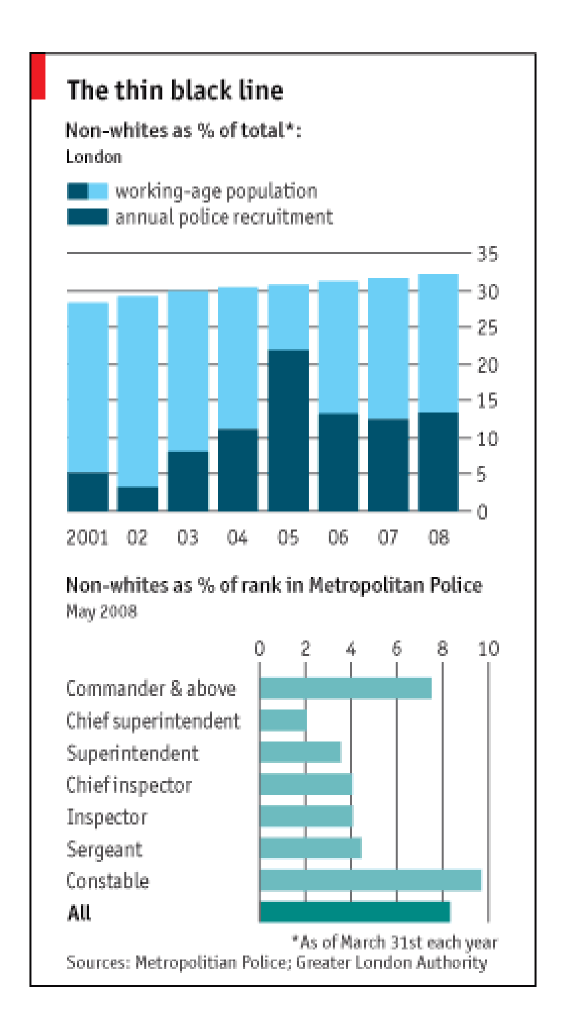
The Met itself is less white than it was. Only 8.2% of its officers are drawn from minorities, but current recruitment levels are better—albeit nowhere near reflecting London's workforce (see chart). The introduction in 2002 of community-support officers—a kind of backup police with weak powers—has helped: in London, which employs more than 4,000, 31% are non-white (and many graduate to being proper policemen after getting a taste for the beat).

But the senior ranks still shine white. Many of the complaints levelled against the force are about being passed over for promotion. Non-white officers do indeed become rarer higher up the ladder (see table), but this is mainly because they are relative newcomers. Among white officers in the Met, 29% have been in the police for 20 years or more, the sort of time it takes to reach the senior ranks. Only 12% of non-white officers have served that long. Perhaps that is because they are bullied out. But those who stick at it do well: nationwide, they are as likely to have reached senior ranks as their white counterparts when their length of service is taken into account, and in some cases slightly likelier. (For example, among officers with ten to 15 years' service, 1.9% of non-whites have reached at least the rank of chief inspector, against 0.9% of whites.)

None of these numbers will console those who have felt racism first hand—and there are still plenty of them. "You have no idea. Maybe no one calls me nigger any more, but it's still there," one officer says. Steve Otter, head of diversity at the Association of Chief Police Officers, admits that tight-knit police culture can be exclusive. But he says forces are working hard to be more open, without losing that bond.

In the meantime, the current row threatens to derail attempts to make the police more mixed. The Black Police Association, whose national president, Ali Dizaei, has a history of bad blood with Sir Ian, has threatened to organise a recruitment boycott among ethnic minorities. Mr Michael strongly opposes the idea, and thinks

Mr Dizaei should step down. “I’m very worried about how his own disagreements with the police service may be enmeshed with his role,” he says. The row looks unlikely to end soon.



The de Menezes inquest

Endangered species

Sep 18th 2008
From The Economist print edition

New light on the tragedy—but future inquests may be held in private

PA



Justice, seen being done

IT IS more than three years since Jean-Charles de Menezes, a 27-year-old Brazilian, was shot dead on a London Tube carriage by police who mistook him for a suicide bomber. Next week, at last, the inquest into his death will begin. So far details of the tragedy have emerged in dribs and drabs from two official investigations and, last year, a successful (though peculiar) prosecution of the police under the Health and Safety at Work Act, a law more commonly used to reprimand careless builders. The inquest will give the de Menezes family their first chance to cross-examine those involved, including the officers who fired the fatal shots. More than 40 policemen are expected to give evidence anonymously, providing new details of what went wrong and why.

The verdict (expected this year) will be delivered by a jury—and in this respect the de Menezes inquest could be among the last of its kind. The Counter-Terrorism Bill now before the House of Lords contains plans to allow sensitive inquests to be held behind closed doors and without juries. At the moment, coroners can call juries at their discretion, but they are obliged to do so if the death occurred in police custody or if it affects public safety. The bill would allow the home secretary to dismiss such juries and order the inquest to be held in private, by a specially vetted coroner. The Home Office says the power would be used rarely (only 2% of inquests require a jury in the first place). Inquest, a campaigning charity, says those rare cases are precisely the ones that ought to be held in public.

The powers are broad: juries could be disbanded not just to protect national security but also “in the interests of the relationship between the United Kingdom and another country”, or simply “otherwise in the public interest”. This could include anything from servicemen killed by “friendly fire” to situations such as the death of David Kelly, a civil servant who committed suicide after leaking information about the government’s case for going to war with Iraq.

Campaigners hope that the Lords will squash the clause. Even if they don’t, it may run into problems with the European Convention on Human Rights. This requires that when a person has been killed, the investigation must allow public scrutiny and involve the next of kin, and that it be carried out by someone independent of those implicated in the death in question. The home secretary is responsible for the police; it would be odd indeed if she were able to appoint the coroner who, in private, investigated police killings.

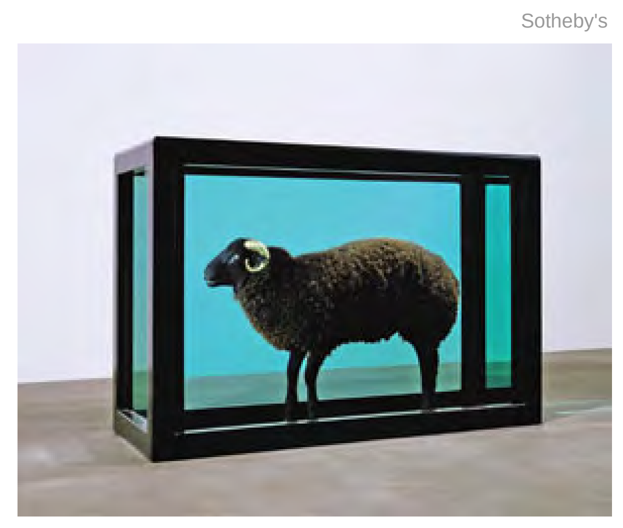
Damien Hirst

The boy done good

Sep 18th 2008
From The Economist print edition

Britain's biggest-selling artist said his sale would fly—and it did

Sotheby's



The golden fleecing

HUNDREDS of artfully placed cigarette butts in one wall installation were toppled over by the whumping bass at the disco party that launched Damien Hirst's auction at Sotheby's in London on September 15th and 16th, and a heckler was escorted off the premises when he tried to interrupt the sale of another multi-million-pound piece. Yet none of that—not even turmoil in the financial markets outside—managed to stem the frenzied bidding.

At the end of the morning session on September 16th, Oliver Barker, Sotheby's youthful international specialist and one of the prime movers behind the sale, was handed a pair of elegant white gloves, the auctioneers' Olympic gold and a symbol that the sale was a sell-out. The gross take for the two days eventually came to £111.4m ($199m).

A show of support by Mr Hirst's two main dealers, and determined bidding by a telephone buyer believed to be Russian, got the principal session off to a brisk start. The mystery buyer paid £12.8m, including premiums, for nine of the evening's 56 lots, including two gold-plated cabinets with industrial diamonds and several butterfly paintings. Gold was the colour of the evening, visible also in the pickled calves and sheep.

Jay Jopling, the London dealer with whom Mr Hirst has worked for nearly 20 years, and a team from Larry Gagosian, the artist's New York dealer, sat prominently in two rows at the centre of the auction room. Their presence was noted, as both dealers had, unusually, been cut out of the Sotheby's auction altogether. They learned of it only in May, when the sale was about to be made public. At the time Mr Gagosian told Frank Dunphy, Mr Hirst's manager: "It sounds like bad business to me. It'll be confusing to collectors. It's a bad move." A peace pact of sorts was agreed just days before the auction, when Mr Dunphy took Mr Gagosian on a tour of the works on offer.

In the event, Mr Gagosian himself decided to travel to Moscow on the night, but a New York associate, Stefan Ratibor, was there bidding heavily for the sale's star lot, "The Golden Calf", a cream-coloured bull preserved in formaldehyde, with solid gold horns, hooves and halo. Bidding opened at £6m for the piece, which was estimated to fetch at least £8m. Mr Ratibor dropped out at £8.5m and the calf was sold finally for £9.2m (£10.4m including premiums). The anonymous telephone buyer was rumoured to be François Pinault, a wealthy French businessman and owner of Sotheby's rival, Christie's, who also bought the top lot at Mr Hirst's Pharmacy sale in October 2004.

If the first night was for princes, the succeeding day sales were definitely for the people. Some bidders, such as Jimmy Lahoud, the business partner of Marco Pierre White, a chef, bought many pieces, as did Gary Tatintsian, a Moscow art dealer. But well over 70 buyers went home with just one memento each. Proof that Mr Dunphy was right when he told *The Economist* before the sale that it would include “something for everyone”. Well, nearly everyone.

The Liberal Democrats

Fighting anonymity

Sep 18th 2008
From The Economist print edition

Britain's third party is the first to offer tax cuts in its fight to get noticed

"I'M TORN between you and the British National Party," a Liberal Democrat activist was told by a voter during a recent election campaign. The voter did not think the party of greenery and civil libertarianism had much in common with the far-right sect; she just wanted to cast a protest vote against Labour and the Conservatives. It was precisely to help the Lib Dems make the leap from a receptacle for disaffection to a serious force in its own right that Nick Clegg, whose first party conference as leader began on September 13th, was elected last year.

Some progress has been made. Bar the occasional gaffe, Mr Clegg is a better performer in Parliament and on television than his predecessor, Sir Menzies Campbell, and the party's poll rating is consistently a few points up from the 14% it plunged to before he took over. Neither is there any appetite for a change of leader. The party has had three in as many years and Mr Clegg, who is just 41, was always a long-term punt in a way that the ageing Sir Menzies never was.

Yet some also mutter that Mr Clegg has trouble getting the media, and therefore most voters, to take much notice of him or his party. Some suggest the tenacious Chris Huhne, who almost beat Mr Clegg to the leadership before becoming the party's home-affairs spokesman, makes better copy. Others say the same of the treasury spokesman, Vince Cable, with his expertise in the issue of the day (the economy) and his eminently quotable put-downs.

It was ironic, therefore, that the crises afflicting the Labour Party and the financial sector drew attention from the boldest gesture of the conference and Mr Clegg's leadership so far. A new fiscal policy approved by the Lib Dems on September 15th would cut spending by £20 billion and return some of it in tax cuts to low- and middle-income earners. It continues a move away from tax-raising manifestos that began under Sir Menzies but, packaged in rhetoric extolling a "smaller state", the policy is unmistakably a nod towards the party's liberal rather than social-democratic traditions. More prosaically, it also helps the Lib Dems in the many seats they are defending from the resurgent Tories, at whom most of the partisan rhetoric at the conference was directed.

What the new fiscal package won't do is stop the Lib Dems being accused of sloppy policy-making, a charge that began to be levied when previous leaders' tax policies failed to withstand scrutiny. The Lib Dems have identified some of the spending cuts they want to make, such as restricting eligibility for tax credits and abolishing the Department for Business, but not the full £20 billion-worth. Neither have they said how much of the money saved would go on tax cuts and how much on spending elsewhere. They are not alone in their fiscal ambiguity (the Tories' famous pledge to "share the proceeds of growth" between tax cuts and extra spending also lacks fine print). But as a third party with a recent history of shaky tax pledges, it is incumbent—fairly or unfairly—on the Lib Dems to get their numbers right.

PA



Hands up for liberalism

The only issue on which the Lib Dems enjoy a lead over the other parties is climate change, according to a Populus poll released on September 15th. But things are broadly looking up. The party's brand is as attractive as the Tories' was once repellent: voters rate them above the rest in being "honest and principled", sharing their values and caring about ordinary people. Their calibre at the top (Mr Clegg, Mr Cable and Mr Huhne would not struggle to find places on the Labour or Tory front benches) is not lost on the public either. They are thought to have a "good team of leaders" by more voters than is the government. And a hung parliament at the next election (still a likely outcome, say some Tories, despite their huge poll leads) could see them in a coalition government.

The party is also more stable and unified than under previous management. Some left-wingers grumble about the tax-cut pledge but it sailed through a conference vote. For Mr Clegg, that may have been a mixed blessing: a showdown with his own party would have grabbed those much-needed headlines.



Tourism

Any port in a storm

Sep 18th 2008
From The Economist print edition

Holidays are the last thing the British want to give up

ON THE face of it, the timing was appalling. On September 17th BAA, which has come under scrutiny from competition boffins for owning and mismanaging most of Britain's big airports, announced that it intended to sell second-string Gatwick, near London. Last month the competition authorities blamed BAA's monopoly in the south-east (besides Heathrow and Gatwick it also owns Stansted, London's third airport) for the awfulness of Heathrow, and said they planned to force the firm to sell two of the three. By putting Gatwick up for sale, BAA hopes to show regulators that it is willing to co-operate, although it insists that it does not agree with their analysis of Heathrow's problems.

But what a moment to do it. The financial sector is in meltdown (see article) and, at first glance, airlines and the travel industry seem to be doing little better. As *The Economist* went to press a rescue plan was hurriedly being put together for Alitalia, Italy's national airline (see article). Among the many airlines that have gone bust so far this year is Silverjet, a British start-up that aimed to offer cheap long-haul business flights. Travel companies too are folding. On September 12th XL Leisure Group, Britain's third-biggest tour operator, collapsed without warning, leaving thousands of holiday-makers stranded overseas. It was the 15th travel firm to close since March.

Yet Gatwick may well attract investors nonetheless. Jammed money markets mean that there is likely to be less competition for it; that could hold its price down (regulators value the airport at around £1.8 billion, but some analysts think it might fetch more). And XL's demise, like most of the airline industry's woes, was due mainly to higher fuel costs, not—so far, at least—to any new-found British aversion to foreign travel.

In fact, for all the bad economic news (see article), official figures show a recession-proof lust for foreign parts: Britons made 3% more trips abroad in the three months to July than in the same period last year, and a healthy chunk of them were off to *gîtes* and beaches. "Holidays are the last thing people cut back on," says Sean Tipton, of the Association of British Travel Agents. Mr Tipton's data show a slight dip in bookings for next summer; but Sara Smalley at Ascent Market Intelligence (Ascent-MI), a travel consultancy, says that these are 2% higher, and breaks this winter are up by 6%. Lastminute.com, an online travel agent, saw a 10% year-on-year increase in the second week of September in people booking their next vacation.

Although the tourism business is not (or not yet) disintegrating, it does seem to be changing. Two-week holidays are becoming a thing of the past, with many people preferring shorter but more frequent breaks. This may partly account for resilient-looking figures.

Travel agents expect other changes, too. One consequence of XL's collapse may—perversely—be an increase in package holidays, at the expense of do-it-yourself bookings. Holiday-makers have learned the hard way that booking directly with an airline can leave them stranded if the company goes bust. XL rather complicatedly consisted of an airline and a hotel-booker, as well as four tour operators. When it went bankrupt, around 12% of its passengers were left without much hope of decent compensation—because they had booked directly with the airline bit of XL or with Medlife Hotels, a subsidiary. The passengers who had bought a holiday "package" through one of XL's tour operators passengers were protected by ATOL (Air Travel Organisers' Licensing), a holiday-rescue fund. They were entitled to free carriage back to Britain, while direct bookers scrabbled to buy a place on the plane.

More perversely still, given a weakening economy, rising unemployment and higher inflation, tastes in holidays seem to be moving upmarket. According to Ms Smalley, there is a steep decline in holidays that cost less than £400 and a commensurate rise in those costing £800 or more, especially to the Caribbean. As gloom mounts at home, it seems that Britons are willing to pay more to escape it. And Gatwick is as good an escape-hatch as any.

Interest rates

When to cut, not if

Sep 18th 2008
From The Economist print edition

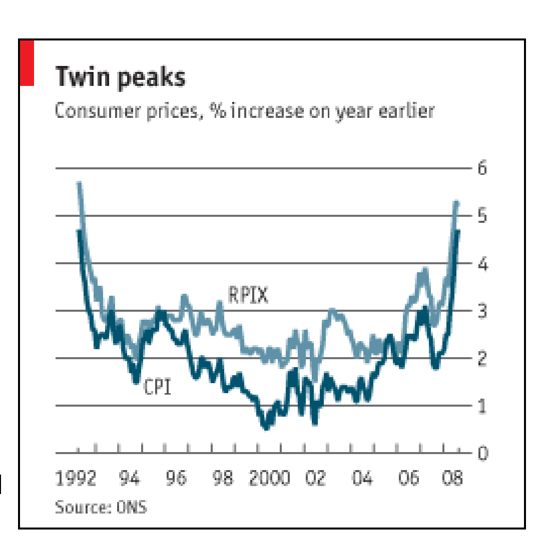
Despite high inflation, an easing in monetary policy is on its way

SINCE cutting the base rate to 5% in April the Bank of England has kept it on hold. At times an increase has seemed likely in order to restrain rising inflation expectations. That is no longer the case. A rate cut is coming: the only question is when.

The central bank responded on September 17th to this week's extraordinary developments—which included the forced merger of Britain's biggest mortgage lender, HBOS (see article)—by extending until the end of January 2009 the period in which banks can swap illiquid mortgage-backed securities on their books at the end of last year for Treasury bills. Only a few days earlier Mervyn King, the governor of the Bank of England, had told MPs that access to the "special liquidity scheme" would cease as scheduled on October 21st.

But even before this unexpected move the central bank's monetary-policy committee (MPC) had shifted its stance on the direction of interest rates, as minutes of its meeting early this month, published on September 17th, made clear. In both July and August, the nine-strong committee had voted three ways. A majority of seven wanted to keep rates on hold, but Tim Besley backed a rise to 5.25% whereas David Blanchflower supported a cut to 4.75%. In September, however, Mr Besley dropped his call for a rate increase and Mr Blanchflower, a consistent dove, argued for a half-point rather than a quarter-point fall.

The objection to loosening monetary policy is that inflation continues to scale new heights. The overshoot of the government's inflation target—that consumer prices should rise by 2% a year—increased still further in August as CPI inflation jumped from 4.4% in July to 4.7%, the highest since April 1992. A broader measure of inflation formerly used for the government's target—retail prices excluding mortgage interest payments (RPIX)—dipped from 5.3% in July to 5.2% but remained uncomfortably high (see chart).



Despite the surge in inflation there are signs that the worst may be over soon. Although the sliding pound has been pushing up import prices fast, the oil shock is subsiding remarkably swiftly. The falling oil price, which dropped below $100 a barrel this week for the first time since March, brought down road-fuel prices in August. Mr King said this week in an open letter to Alistair Darling, the chancellor of the exchequer, that the MPC "now expects inflation to peak soon at around 5%".

This forecast is considerably higher than the one Mr King made three months ago, when he told the chancellor that he expected inflation to rise above 4% in the second half of 2008. On the other hand, the peak looks set to arrive earlier; in his June letter, Mr King thought it would come around the end of the year. The sooner inflation starts to retreat, the easier it will be for the central bank to cut rates; it is hard to make the case for looser policy when inflation keeps hitting new highs.

The other reason why the MPC's stance is shifting is that the economy looks as if it is now shrinking. New figures on the labour market published this week are further evidence of the downturn. The number of people claiming unemployment benefit rose for the seventh consecutive month in August; and the increase of 32,500 was the biggest since December 1992, when the economy was only just emerging from a harsh recession.

Mr King said this week that the scale of the inflation overshoot had made the MPC "firmer in its belief that a period of muted economic growth is necessary to dampen pressures on prices and wages". Yet the MPC

does not want to subject the economy to overkill. That risk has grown following this week’s financial strains, which will make banks less able and less willing to extend credit.

The precise timing of a rate reduction remains uncertain. But there is now little doubt that a cut will be made some time in the next three months.



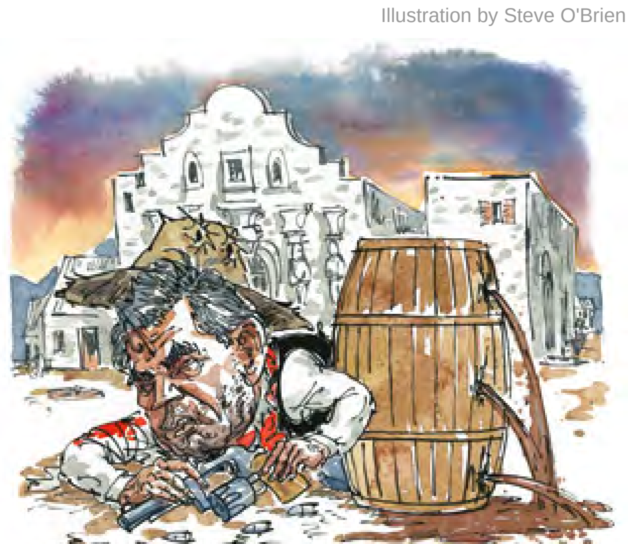

Bagehot

Gordon’s last stand

Sep 18th 2008
From The Economist print edition

The prime minister’s best hope of survival may be to come out fighting

Illustration by Steve O'Brien



Gordon Brown

IT WAS quiet out there—too quiet. The rumours of Labour plots and putsches had been rumbling for months, but there was no sign of an attack, other than a couple of minatory articles in left-wing magazines. Then, finally, they came over the horizon, a small and motley rabble of would-be assassins, whom Gordon Brown saw off with ease. Ker-boom! A junior whip, an envoy to Cyprus and the vice-chairman of the Labour Party were sacked. An obscure minister in the Scottish office fell on his sword. Then the smoke cleared, and it was quiet again. The cabinet emerged from the Downing Street redoubt to proclaim its loyalty.

There is a similar moment in many cowboy films: the surrounded posse see off an onslaught, then look around smilingly, thinking the worst is over. Usually it isn’t—and neither is the danger of insurrection for Mr Brown.

That is not because the barrage of criticism aimed at his leadership by a dozen or so obscure MPs has been cunningly organised. Had their manoeuvres been overseen by some scheming Blairite general, the denunciations and resignations would have been better choreographed. Instead, a ragtag militia trooped out randomly, trying and failing to invoke an abstruse party rule on leadership nominations in advance of the Labour conference, which begins on September 20th. Efforts to detect a link among the insurgents (some are from Lancashire, others London, a few Scotland; they are all Sagittarians, etc) have failed.

On the contrary, it is because it has been disorganised that the assault may prove telling. It seems motivated not by ancient grudges or thwarted ambition, but by two simple, kamikaze calculations: that under Mr Brown’s leadership Labour is destined to defeat at the next general election; and that, by ousting him, it can exchange a certain rout for an outside chance of recovery. Because it was amateurish, the revolt has been unusually frank.

The debate about Mr Brown’s leadership has hitherto been conducted in absurd Westminster euphemism. When David Miliband, the foreign secretary, published a newspaper article in July that was codedly critical of his boss, the commentariat lauded his *cojones*. But the code was opaque to almost everyone else. Not so now. One rebel complains accurately that “the public has stopped listening” to Mr Brown. Another observes that Mr Brown is the most unpopular prime minister since Neville Chamberlain. David Cairns, the

now-ex Scottish minister, says that “the issues of leadership and direction are being discussed…to go on denying it is hardly credible.”

These sentiments cannot now be unsaid. Moreover, they are shared by many other MPs, including many government ministers. Labourites used to worry that, if they ditched Mr Brown, a new leader might feel obliged to call an early election, which Labour would lose; many now fear that sparing Mr Brown may be riskier, since it would make the eventual defeat catastrophic. (There is also a hope that a new prime minister installed soon would have a few winter months to manufacture a bounce, before calling an election in the spring—a useful hiatus that might not be available if the party waits much longer.) For all its public loyalty, the cabinet is said to have been unimpressed by Mr Brown’s exhortations at their meeting on September 16th. The senior “men in grey suits”, whom the rebels are relying on to force him out, may well materialise when the time seems propitious.

So Mr Brown’s grip on the premiership is precarious. It is true, as he and his allies argue, that the convulsions of the global economy make this a poor moment for Labour to be, or seem, preoccupied with its poll ratings; indeed, the worse the economic news gets, the stronger this argument will seem. Unfortunately, not only has Mr Brown’s status in the party been challenged: his authority in the country, and thus his ability to govern, has been damaged too. For the sake of both, he urgently needs to reassert it.

Gordon Cassidy and the Sundance Balls

But how? His speech to the Labour conference on September 23rd has been billed as Mr Brown’s Alamo. Yet even soaring rhetoric, imaginative policies and wild ovations are unlikely to be enough: Margaret Thatcher managed a barnstormer in 1990, and was defenestrated soon afterwards. The notion that new policies can rescue Mr Brown is probably misguided too. People make policies popular or unpopular as much as vice versa; new schemes from Mr Brown may flop purely because they are his.

His next chance may be the reshuffle that has been mooted for October. There is a risk, though, that when reshuffled ministers are implicitly asked to reaffirm their loyalty some may quit instead. Promoting loyal sidekicks such as Ed Balls, the education secretary, might look neurotically clannish. In any case, most current ministers have such low profiles that the public is unlikely to notice or care if they are moved. Another chance comes later in the autumn, with the by-election in the Scottish constituency of Glenrothes. A thumping Labour win might assuage the party—but Mr Brown would be naive to bank on one.

Rather than relying on these dubious opportunities, Mr Brown instead could come out fighting—by voluntarily submitting himself to a leadership contest, as John Major did in 1995. The resulting clarity would be good for the country, and conceivably for Mr Brown too: since the rebels are focused on deposing him, and have no consensus on who ought to replace him, he might even stand a chance of emulating Mr Major’s victory.

Alas, on past form, Mr Brown won’t risk it. He shied away from challenging Tony Blair in 1994, and last year managed to avoid a leadership contest that might have enhanced his legitimacy. This time, however, he may be unable to dodge a showdown. Perhaps after Glenrothes, maybe sooner, the rebels will probably be back. Mr Cairns and the rest may come to resemble the bit-part characters who are often sacrificed at the beginning of the film, but whose comrades eventually triumph.

Economist.com WORLD INTERNATIONAL

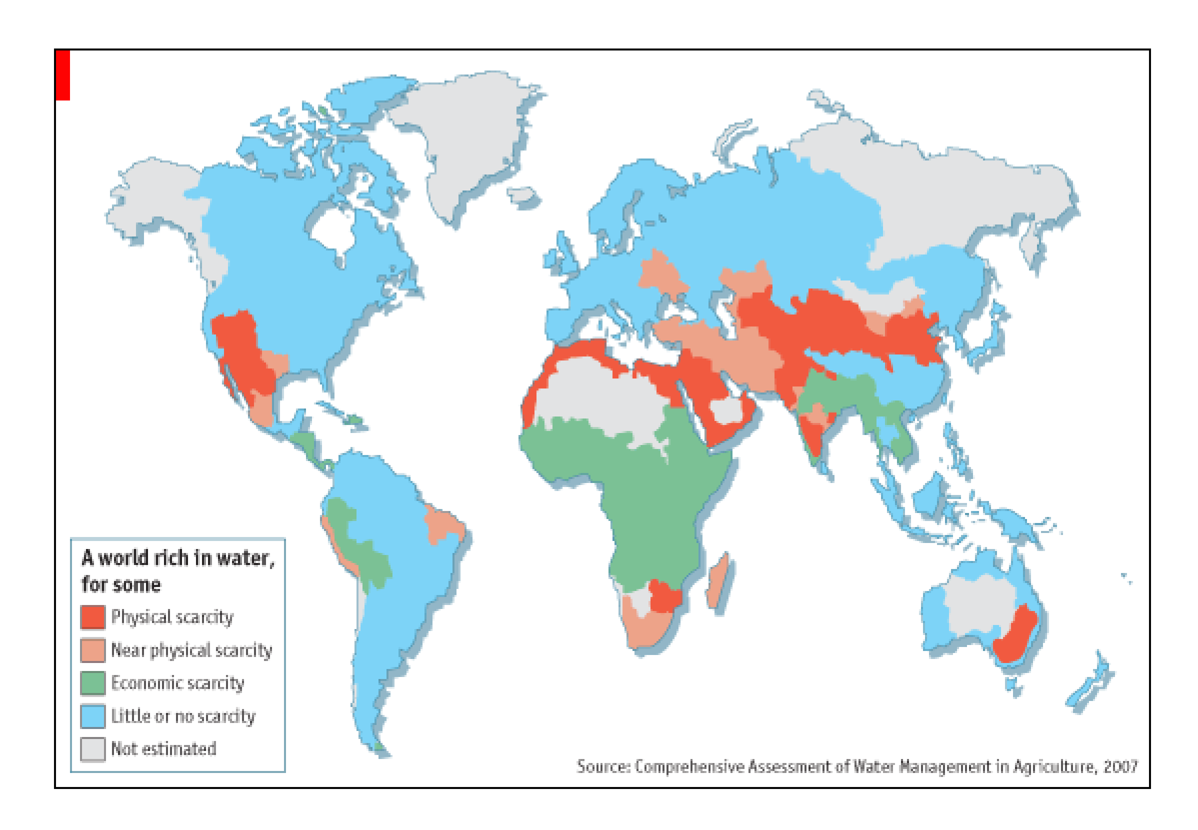
Water for farming

Running dry

Sep 18th 2008
From The Economist print edition

The world has a water shortage, not a food shortage

MOST people may drink only two litres of water a day, but they consume about 3,000 if the water that goes into their food is taken into account. The rich gulp down far more, since they tend to eat more meat, which takes far more water to produce than grains. So as the world's population grows and incomes rise, farmers will—if they use today's methods—need a great deal more water to keep everyone fed: 2,000 more cubic kilometres a year by 2030, according to the International Water Management Institute (IWMI), a research centre, or over a quarter more than they use today. Yet in many farming regions, water is scarce and likely to get scarcer as global warming worsens. The world is facing not so much a food crisis as a water crisis, argues Colin Chartres, IWMI's director-general.



The solution, Mr Chartres and others contend, is more efficient use of water or, as the sloganeers put it, "more crop per drop". Some 1.2 billion people, about a fifth of the world's population, live in places that are short of water (see map). Farming accounts for roughly 70% of human water consumption. So when water starts to run out, as is happening in northern China, southern Spain and the western United States, among other places, farming tends to offer the best potential for thrift. But governments, whether to win votes or to protect the poor, rarely charge farmers a market price for water. So they are usually more wasteful than other consumers—even though the value they create from the water is often less than households or industry would be willing to pay for it.

The pressing need is to make water go further. Antoine Frérot, the head of the water division of Veolia Environnement, a French firm, promotes recycling, whereby city wastewater is treated until it can be used in industry or agriculture. This costs about a third less than desalination, and cuts pollution. He expects his recycling business to quadruple in the next decade.

Yet as Mr Frérot himself concedes, there are many even cheaper ways to save water. As much as 70% of water used by farmers never gets to crops, perhaps lost through leaky irrigation channels or by draining into rivers or groundwater. Investment in drip irrigation, or simply repairing the worst leaks, could bring

huge savings.

Farmers in poor countries can usually afford such things only if they are growing cash crops, says David Molden of IWMI. Even basic kit such as small rainwater tanks can be lacking. Ethiopia, for example, has only 38 cubic metres of storage capacity per inhabitant, compared to almost 5,000 in Australia. Yet modest water storage can hugely improve yields in rain-fed agriculture, by smoothing over short dry spells. Likewise, pumping water into natural aquifers for seasonal storage tends to be much cheaper than building a big dam, and prevents the great waste of water through evaporation.

Even when water is scarce, it is often squandered. Mr Molden cites the example of cotton-farmers in Uzbekistan, who used to receive a fixed allocation of water for irrigation whether they needed it or not, in a holdover from the days of Soviet central planning. Simply putting farmers in control of the irrigation network, and allowing them to decide how much water they needed, cut consumption by 30%.

Similarly, rice farmers can sharply cut water consumption by flooding paddy fields only some of the time. Wheat growers in hot places such as India and Australia can conserve water by minimising tilling, leaving a layer of mulch on the fields' surface to absorb rainwater and limit evaporation. In arid regions like the Middle East, Mark Zeitoun of the London School of Economics suggests substituting thirsty crops such as oranges with more abstemious olives and dates. Ideally, countries that are short of water would concentrate on growing the most valuable cash crops, and use the proceeds to import staples.

Science Photo Library



Cotton paying a high price for water

Agronomists are beginning to devise tools to help monitor the efficiency of water use. Some have designed algorithms that use satellite data on surface temperatures to calculate the rate at which plants are absorbing and transpiring water. That allows governments and development agencies to concentrate their efforts on the most prodigal areas.

But efficient use of water, cautions Pasquale Steduto of the United Nations' Food and Agriculture Organisation, is just one step to better agricultural yields. Even if farmers use the right amount of water they also need decent seeds and enough fertiliser. In Africa in particular, these and other factors such as pest control, storage and distribution are a bigger drag on yields than a shortage of water.

Raising yields does not always involve greater water consumption, especially when farms are inefficient. It would take little extra water to double cereal output in many parts of Africa, Mr Molden argues. IWMI reckons that some three-quarters of the extra food the world needs could be provided simply by bringing yields in poor countries closer to those of rich ones. That is more palatable than the puritanical alternative: giving up meat and other thirsty products altogether.

Quotas

Women rising

Sep 18th 2008
From The Economist print edition

Quotas to help women reach power are spreading

WHEN Rwandans went to the polls on September 15th, one part of the result was not in doubt: nearly one-third of their elected parliamentarians would be women. And probably more: in the outgoing parliament, nearly half the members were female. That level of representation—once seldom seen outside Scandinavia—has less to do with an upsurge in feminist thinking than with a law passed in 2003 that guaranteed women 30% of the seats. The aim was to break up "old boy" networks and help the country make a new start in its first elections since the 1994 genocide.

Such legal privileges, known as "gender-based quotas" by supporters, are catching on. Around 110 countries have rules helping women to get elected, joined in recent years by such feminist-friendly places as Afghanistan, Iraq and Sudan. On September 5th Angola had its first election with a new quota in place that says 30% of candidates must be women. Yemen is discussing a similar measure.

Quota laws may reserve a certain number of seats in the legislature for women, or instruct political parties to present a minimum proportion of female candidates (something parties in countries such as Britain and Germany may do voluntarily anyway).

The trend to quotas is most visible in countries where a legal leg-up can overcome prejudice, in the form of violence, shortage of cash, or lack of media attention. But even in the European Union—probably the best place on the planet from the point of view of women's rights—the issue is a hot one. In the European Parliament, Lissy Gröner, a German Social Democrat, is campaigning for half of all the top jobs in EU institutions to be reserved for women.

Supporters argue that having more women in politics is not only fair, but also beneficial. Research suggests that, at least in poorer countries, quota laws change the subjects that lawmakers discuss. A law in Rwanda that defines rape and protects victims of sexual abuse got through thanks to women legislators; their male counterparts saw the subject as taboo. A study co-authored by Esther Duflo, an academic at the Massachusetts Institute of Technology, says that women lawmakers focus more on public goods and take fewer bribes. Another study carried out in India showed that female politicians promoted public-works projects that mattered particularly to women, such as well-construction.

Yet quotas also raise hackles. Why should voters' choices be limited by artificial categories? Quotas also risk diluting the quality of decision-making: if women candidates are good, voters will choose them anyway; if they are not good, why do they deserve to be elected? Another objection is that plenty of women have done well without them. Angela Merkel in Germany and Tzipi Livni in Israel, as well as Hillary Clinton and Sarah Palin in America, have won elections without help from quotas. Legal privileges may help get women into politics. But something else makes them reach the top.

Malaria

Counting bites

Sep 18th 2008
From The Economist print edition

The number of malaria cases is down sharply, for reasons good and bad

AT FIRST blush, the change seems like staggeringly good news. The World Health Organisation (WHO) has just issued a new report on malaria. The agency's experts estimate that each year there are some 250m cases of malaria globally. That is a huge fall from the previous 350m-500m figure in a 2005 report.

A happy confluence of funding, political will and practical tools is indeed making a difference. Drug treatment that combines artemisinin, a powerful anti-malaria treatment, with other medicines, and the use of insecticide-embedded bed nets, are particularly effective.

Thanks to that, 20-plus countries outside Africa have seen their malaria burden decline in recent years. And even within Africa, which accounts for most of the world's 880,000 or so malaria deaths each year, a handful of countries have made excellent progress. The number of new malaria cases in Eritrea fell by more than a half between 2001 and 2006. Rwanda and São Tomé and Príncipe made big gains too.

Sadly, the bigger reason for the seeming drop in the total number of malaria cases is the way the WHO counts them, a tricky task in countries with weak health-care systems. Previous reports relied on estimates dating back to the 1950s and 1960s in some countries outside sub-Saharan Africa. The new methodology takes the actual number of malaria cases reported by local health authorities as a starting point. Nearly half the fall comes thanks to counting cases in India by the new method.

The report comes on the eve of a United Nations malaria summit in New York on September 25th. Governments, philanthropic outfits (notably the Gates foundation), activists and celebrities will launch a new global strategy and collect hefty pledges in its support. Campaigners say that malaria's moment has finally arrived.

If so, the assembled worthies may pay attention to a point made by Amir Attaran of the University of Ottawa. He argues that malaria and similar diseases need to be monitored like the weather, with what he calls "sentinel surveillance networks" throughout the developing world. This is essential both to measure malaria incidence more accurately and to assess the success or failure of various policies.

With enough time and effort, big reductions in malaria caseloads reported in future WHO studies could even be cause for celebration rather than embarrassment.

A bigger world

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From The Economist print edition

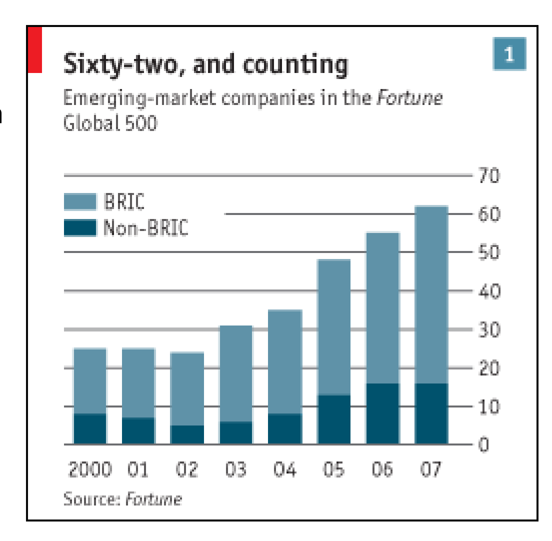
Illustration by James Fryer



Globalisation is entering a new phase, with emerging-market companies now competing furiously against rich-country ones. Matthew Bishop (interviewed here) asks what that will mean for capitalism

GLOBALISATION used to mean, by and large, that business expanded from developed to emerging economies. Now it flows in both directions, and increasingly also from one developing economy to another. Business these days is all about "competing with everyone from everywhere for everything", write the authors of "Globality", a new book on this latest phase of globalisation by the Boston Consulting Group (BCG).

One sign of the times is the growing number of companies from emerging markets that appear in the *Fortune* 500 rankings of the world's biggest firms. It now stands at 62, mostly from the so-called BRIC economies of Brazil, Russia, India and China, up from 31 in 2003 (see chart 1), and is set to rise rapidly. On current trends, emerging-market companies will account for one-third of the *Fortune* list within ten years, predicts Mark Spelman, head of a global think-tank run by Accenture, a consultancy.



There has been a sharp increase in the number of emerging-market companies acquiring established rich-world businesses and brands (see chart 2), starkly demonstrating that "globalisation" is no longer just another word for "Americanisation". Within the past year, Budweiser, America's favourite beer, has been bought by a Belgian-Brazilian conglomerate. And several of America's leading financial institutions avoided bankruptcy only by going cap in hand to the sovereign-wealth funds (state-owned investment funds) of various Arab kingdoms and the Chinese government.

One example of this seismic shift in global business is Lenovo, a Chinese computer-maker. It became a global brand in 2005, when it paid around $1.75 billion for the personal-computer business of one of America's best-known companies, IBM—including the ThinkPad laptop range beloved of many businessmen. Lenovo had the right to use the IBM brand for five years, but dropped it two years ahead of schedule, such was its confidence in its own brand. It has only just squeezed into 499th

place in the *Fortune* 500, with worldwide revenues of $16.8 billion last year. But "this is just the start. We have big plans to grow," says Yang Yuanqing, Lenovo's chairman.

One reason why his company could afford to buy a piece of Big Blue was its leading position in a domestic market buoyed by GDP growth rates that dwarf those in developed countries. These are lifting the incomes of millions of people to a level where they start to splash out on everything from new homes to cars to computers. "It took 25 years for the PC to get to the first billion consumers; the next billion should take seven years," says Bill Amelio, Lenovo's chief executive.

Lean and hungry 2

Top five emerging-market M&As

Year	Target	Buyer	Deal value $bn
2006	Inco *Canada*	Companhia Vale do Rio Doce, *Brazil*	18.7
2006	Rinker Group *Australia*	Cemex SA de CV *Mexico*	16.7
2008	Rio Tinto (12%) *Britain*	Alcoa; Aluminum Corp of China *US; China*	14.3
2006	Corus Group *Britain*	Tata Group *India*	13.0
2007	GE Plastics *US*	Saudi Basic Industries Corp, *Saudi Arabia*	11.6

Source: Dealogic

The sheer size of the consumer markets now opening up in emerging economies, especially in India and China, and their rapid growth rates, will shift the balance of business activity far more than the earlier rise of less populous economies such as Japan and South Korea and their handful of "new champions" that seemed to threaten the old order at the time.

This special report will argue that the age of "globality" is creating huge opportunities—as well as threats—for developed-world multinationals and new champions alike. The macroeconomic turbulence that the world is now going through after almost a decade of smooth growth will probably not alter the picture fundamentally, but it will complicate it. Despite all the talk of "decoupling", emerging economies have recently been growing more slowly because of their exposure to increasingly cautious American consumers.

Moreover, high oil and food prices are creating inflationary pressures in many emerging countries that had enjoyed years of stable, low prices along with extraordinary economic growth. The side-effects of rapid development, such as pollution and water shortages, also need to be tackled. "After a long period in which globalisation has been all about labour productivity, the business challenge everywhere, and especially in emerging markets, will increasingly be to raise resource productivity—using fuel, raw materials and water more efficiently," says Bob Hormats of Goldman Sachs, an investment bank.

A cheaper mousetrap

Assuming that the upbeat growth forecasts for emerging markets remain broadly on track and the developed economies get back on their feet, what will be the main competitive battlegrounds of global business? One is those new consumers, who often demand products at far lower prices and often in more basic forms or smaller sizes than their developed-country counterparts. Emerging-market firms with experience of serving these consumers think they are better placed to devise such products than their developed-world competitors. Lenovo, for example, is going after the developing world's rural markets with a cheap, customised PC that enables farmers to become networked.

Some of these innovations have global potential. Lenovo's Chinese R&D labs developed a button that recovers a computer system within 60 seconds of a crash, essential in countries with an unreliable power supply. Known as "Express Repair", this is now being incorporated into its computers everywhere.

The same logic may apply to innovations in business models that allow goods and services to be delivered in fundamentally different ways and at much lower cost. Lenovo, for example, has developed a highly effective formula for selling to Chinese consumers that it has since taken to India and America.

Yet the rise of the new champions has brought a vigorous response from some of the old ones. IBM may have felt that it was no longer worth its while to compete in PCs, but Lenovo is facing fierce competition from American companies such as Hewlett-Packard and Dell everywhere, including in China. Nor was IBM's decision to sell its (low-margin) PC business due to a lack of commitment to emerging markets: it now employs 73,000 people in India, against 2,000 at the start of the decade, and hopes to increase the share of its global revenues coming from emerging markets from 18% now to 30% within five years.

Although multinational companies in developed countries must grapple with legacy costs of various kinds—financial (pensions, health-care liabilities), organisational (headquarters far away from new markets) and cultural (old ways of thinking)—they have advantages too. The greatest of these may be a deep well of managerial experience, which emerging-market firms often lack. Yet Lenovo has shown how to overcome this management deficit by hiring a group of seasoned international executives, including Mr Amelio, an American who cut his managerial teeth at IBM and Dell.

The new giants 3

Ten biggest *Fortune* Global 500 emerging-market companies, 2008

Company	Country	Global 500 rank	Revenue $bn
Sinopec	China	16	159.3
State Grid	China	24	132.9
China National Petroleum	China	25	129.8
Pemex	Mexico	42	104.0
Gazprom	Russia	47	98.6
Petrobras	Brazil	63	87.7
Lukoil	Russia	90	67.2
Petronas	Malaysia	95	66.2
Indian Oil	India	116	57.4
Industrial & Commercial Bank of China	China	133	51.5

Source: *Fortune*

But Lenovo went further than hiring international managers. "We are proud of our Chinese roots," says Mr Yang, but "we no longer want to be positioned as a Chinese company. We want to be a truly global company." So the firm has no headquarters; the meetings of its senior managers rotate among its bases around the world. Its development teams are made up of people in several centres around the world, often working together virtually. The firm's global marketing department is in Bangalore.

A huge effort has been made to integrate the different cultures within the firm. "In all situations: assume good intentions; be intentional about understanding others and being understood; respect cultural differences," reads one of many tip sheets issued by the firm to promote "effective teamwork across cultures". Mr Yang even moved his family to live in North Carolina to allow him to learn more about American culture and to improve his already respectable command of English, the language of global business.

In short, Lenovo is well on its way to becoming a role model for a successful multinational company in the age of globality: a good reason to be optimistic about the future of capitalism, even capitalism with a Chinese face. Perhaps Lenovo and other new champions will become the first of a new breed of truly global companies, rooted in neither rich nor developed countries but aiding wealth creation by making the most of opportunities the world over.

Good and bad capitalism

But is such optimism justified? Indeed, would Lenovo even have been allowed to buy IBM's PC business today? Congress nearly blocked the deal at the time because it feared that valuable intellectual property might fall into the hands of the Chinese government. Since then, China-bashing has increased, there has been some Arab-bashing too, deals have been blocked and the rhetoric in Washington, DC, has become ever more protectionist.

One fear is that American jobs will disappear overseas. This is despite plenty of academic evidence that open economies generally do better than closed ones, that in America in particular many more and generally better jobs have been created in recent years than have been destroyed, and that the number of jobs lost to outsourcing is tiny compared with those wiped out by technological innovation. Mr Yang explains that "people thought we would manufacture all our products in China, but in fact we have opened new plants in Greensboro and also Poland, as we need to be close to our customers."

Lately a new fear has been adding to the protectionist sentiment, turning even some usually enthusiastic global capitalists into protectionists. Could the rise of the new champions reflect the advance of bad forms of capitalism at the expense of good forms?

In their 2007 book, "Good Capitalism, Bad Capitalism and the Economics of Prosperity and Growth", William Baumol, Robert Litan and Carl Schramm identify four main models of capitalism around the world: entrepreneurial, big-firm, oligarchic (dominated by a small group of individuals) and state-led. Most economies are a mixture of at least two of these. The best economies, say the authors, blend big-firm and entrepreneurial capitalism. The worst combination may be of oligarchic and state-led capitalism, both of which are prevalent in many emerging markets.

The worriers point out that, through corporate acquisitions and the investments of sovereign-wealth funds, the role of the state (often an undemocratic one) in the global economy is rapidly expanding. Given the lamentable history of state intervention in business, they say, this does not bode well.

Such fears are not easily dismissed, if only because what is happening is so new that there is not much evidence either way. Sovereign-wealth funds insist that they are interested only in getting a good return on their money and will not meddle in politics. Perhaps they will turn out to be sources of good corporate governance and patient capital, in admirable contrast to the growing number of short-termist institutional investors in developed countries. But perhaps they will not.

Again, Lenovo offers an encouraging example. Even though its largest shareholder is in effect the government of China, its acquisition of IBM's PC business does not seem to have had any troubling consequences. But maybe the Chinese government was restrained by its co-investors, two of America's leading private-equity firms. Besides, the new champions may be typified not by Lenovo but by, say, Gazprom, through which the Russian state can make mischief abroad. As Mr Yang points out, of the 29 Chinese firms in the *Fortune* 500, Lenovo is the "only one that is truly market-driven". Most of the rest enjoy monopoly power or operate in the natural-resources industries, where there is far more scope for politics and corruption than in consumer electronics.

At the very least, the growing role of states that often lack democratic credentials creates a sense that the competition from emerging-economy champions and investors is unfair, and that rich-country firms may lose out to less well-run competitors which enjoy subsidised capital, help from political cronies or privileged access to resource supplies.

So there is a real risk that bad capitalism will spread in the coming decades. Yet at the same time this latest, multidirectional phase of globalisation offers enormous potential for business to raise living standards around the world.

The new champions

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Illustration by James Fryer



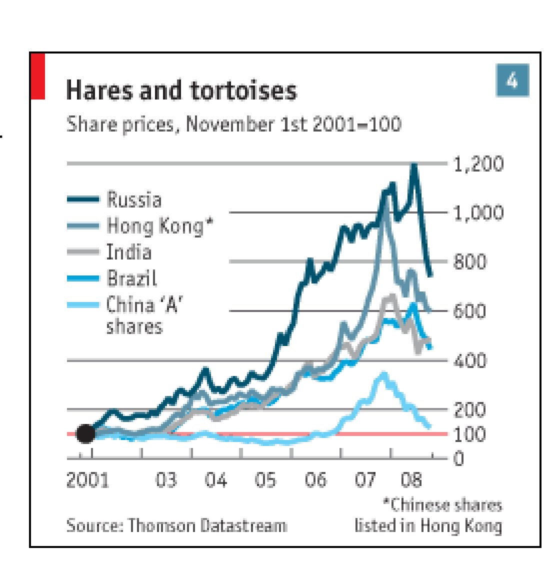
Emerging markets are producing examples of capitalism at its best

SAFARICOM may not be a household name in the rest of the world, but in Kenya it is famous. On June 9th the country's most popular mobile-phone company, with 10.5m customers, listed its shares on the Nairobi stock exchange, raising over $800m in the biggest initial public offering yet in sub-Saharan Africa. The offering was nearly five times oversubscribed, and Safaricom's share price quickly rose by 60%.

Even sub-Saharan Africa is feeling its way towards the emerging-markets bandwagon. In January Goldman Sachs published its first bullish report on the continent, "Africa Rising", noting at the time that sub-Saharan stockmarkets in 15 countries (excluding mighty South Africa) listed around 500 companies with a market capitalisation of nearly $100 billion.

Seven years after Goldman Sachs invented the BRICs acronym, the performance of the emerging stockmarkets is running well ahead of the bank's high expectations. Even after recent falls, at the start of this month Brazilian shares were up by 345% since November 2001, India's by 390%, Russia's by 639% and China's, depending on whether you go by the mainland or the Hong Kong exchange, by 26% or 500% (see chart 4). In 2001 Goldman Sachs had predicted that by the end of the decade the BRIC economies would account for 10% of global GDP at purchasing-power parity (PPP); by 2007 their share was already 14%. The investment bank now expects China's GDP to surpass America's before 2030.

Most economists believe that this upward trend will not be seriously broken by the current economic slowdown. Nor is it restricted to the BRICs. In 2005, for the first time since the dawning of the industrial age, emerging economies accounted for more than half of global GDP at PPP.



Yet the emerging markets are not merely generating economic growth. They are also producing companies that are worth investing in, and that are even starting to take on and beat the best of the developed world's multinationals. As well as Lenovo, the new champions listed by Antoine van Agtmael in his book "The Emerging Markets Century" include Haier, a Chinese white-goods firm; Cemex, a Mexican cement company; Embraer, a Brazilian aircraft-maker; Infosys, an Indian software giant; and Ranbaxy, an Indian drug company. The list of emerging firms in "Globality" that are said to be "changing the game in every

industry" also includes firms such as Goodbaby, which has an
80% share of the market for baby buggies in China and a 28% share in America, and the Tata Group, an Indian conglomerate that spans cars and steel, software and tea.

Lately, Tata, which has operations in 85 countries, has been making a series of high-profile acquisitions that are fundamentally transforming a company set up in 1868. In 2000 it bought London-based Tetley, an iconic tea company. In 2007, after a fierce bidding war with CSN, a Brazilian steel firm, it paid $12 billion for Corus, a European steel company. In March this year it paid Ford $2.3 billion for two legendary car businesses, Jaguar and Land Rover.

Tata could afford to pay high prices for its acquisitions, reflecting the growing financial strength of some of the new champions. In part, they are benefiting from having large, profitable shares of fast-growing domestic markets. The rapid development of domestic financial markets in many emerging economies—not just stock exchanges, but also markets for corporate debt—has also made it far easier to get the capital needed to expand abroad.

Equally, rich-country capital markets nowadays are open to and actively recruiting emerging-market companies. The New York Stock Exchange is even seeking to list its shares on the Shanghai stock exchange. And the world's leading consultants, law firms and investment banks are courting emerging-market companies at which, not so long ago, they would have turned up their noses. McKinsey, a consultancy, has advised Lenovo on how to unite its Chinese and American cultures. Goldman Sachs has appointed Lakshmi Mittal, an Indian steel magnate, to its board.

Tata rejects suggestions that it overpaid for its acquisitions—a charge that has been levelled at several of the new champions. It insists it is paying prices justified by its long-term investment horizon and its philosophy of deep decentralisation that gives plenty of freedom to the management teams it acquires (and typically leaves in place). The acquisition of Jaguar and Land Rover is a case in point. Short-term market pressure may have forced Ford to sell two firms that it had done good work restructuring, says Alan Rosling, Tata's (British) chief strategist: "Tata will reap the benefit of all Ford's hard work."

Another reason to be optimistic about Tata's growing global reach is its Indian origin, which makes it more sensitive to cultural differences than many of its peers in developed countries, claims Mr Rosling. And in its strategy, the firm has benchmarked itself against some of the world's best companies. It has borrowed ideas from firms such as Warren Buffett's Berkshire Hathaway, Mitsubishi, a Japanese conglomerate, and GE, says Mr Rosling.

The new champions are becoming increasingly innovative, both in their business models and in their products. For instance, Tata Consulting Services, along with Indian counterparts such as Infosys and Wipro, has built up a large organisation for outsourcing business processes, serving companies around the world. Initially this was a fairly low-tech operation, thriving largely on India's low labour costs. Increasingly, however, it has moved into higher-value businesses, as have its Indian peers.

Frugal engineering

Not so long ago, the most exciting thing about emerging markets was their cheap labour. Local firms supplied first manufactured goods and then services to developed markets and multinationals. That remains an attraction, but a declining one as wages in emerging markets and transport costs go up. No one expects Walmart, the world's largest retailer, to rethink its famously efficient supply chain, which brings billions of dollars-worth of Chinese goods to the developed world. But these days multinational firms are looking for the skills that workers from emerging markets can bring to a job as much as for lower labour costs.

Increasingly, though, the most exciting thing about emerging countries is the rapid growth in the number of consumers in their own markets, and in the number of entrepreneurs to serve them. Already, wealthy consumers in these countries have proved a godsend to the world's leading brands of luxury goods. But the emerging markets' new middle class may also have helped many new champions along.

Goldman Sachs calculates that the global middle class—which it defines as people with annual incomes ranging from $6,000 to $30,000—is growing by 70m a year and rising. By 2030, the bank predicts, another 2 billion people may have joined this group. At incomes of $6,000 the consumption of energy starts to rise, and at $8,000-9,000 purchases of higher-value consumer durables take off, so the growth in demand for these things already under way in emerging countries should continue for many years.

One of the first management gurus to note the rise of the emerging-market consumer was C.K. Prahalad in his book, “The Fortune at the Bottom of the Pyramid”. He argued that to serve these new consumers—both in the new middle classes and at the bottom of the income pyramid—companies will need new business models and products that are profitable at much lower prices than in rich countries.

Companies from emerging markets may be more adept than their rich-country rivals at making do with the bare minimum of resources—“frugal engineering”, as Carlos Ghosn, the boss of Renault-Nissan, calls it. And it may be much easier for a company starting from scratch than for an established firm with a “legacy mindset and legacy costs”, says Mr Prahalad. The rapid spread of mobile telephony among poorer consumers in the emerging markets is one notable example. AirTel, the Indian market leader, charges what may be the lowest prices in the world—around two cents a minute for nationwide calls—yet is hugely profitable, thanks to an innovative business model in which many of its operations are outsourced to big multinationals such as Ericsson and IBM.

Safaricom joins a group of emerging-market mobile-phone companies with a combined market capitalisation which Mr Prahalad estimates at $500 billion. “Poor people, once mobilised and provided with value, can create tremendous wealth for business,” he says. He sees similar potential in a number of other industries, ranging from agribusiness to health care and water to finance.

What it takes to succeed

Mr Prahalad says he can now answer “yes” to five questions he posed seven years ago when he launched his pyramid idea. Is there a real market? Is it scalable? Is there profit? Is there innovation? Is there a global opportunity? Soon, he reckons, firms in emerging markets will develop products that “straddle the pyramid”—developing basic high-quality products, but differentiating between customers at different income levels by adding various “bells and whistles for the rich”. For instance, a mobile phone may include a torch-light for poorer customers and a fancy camera for the better-off.

Tata, too, is at the forefront of this frugal-engineering trend. In January it unveiled its long-awaited Nano, a new “people’s car” that will be sold for just $2,500. This was “not just the result of using cheap Indian engineers”, says Mr Rosling. Nor is it about accepting lower standards on safety or environmental emissions. The company used state-of-the-art virtual design technology and global teams to drive genuine innovation. Mr Tata saw the Nano as a safer alternative for Indian families currently travelling by motorcycle, but consumers in developed countries are already talking of it as a possible second car for use in towns because, being small, it is easy to park. Still, the Nano will probably sell best in other emerging markets.

Already, new champions such as AirTel and Desarrolladora Homex, a Mexican builder of low-cost housing, are planning to take their innovative business models and pricing to other emerging markets, betting that they will transfer more easily between developing economies than from developing to developed ones. Homex hopes to serve communities “in highly populated and underserved areas where we believe our replicable business model will be most effective,” says its chief executive, Gerardo de Nicolas.

The company is investing a total of $4m in a joint venture called Homex India and has struck an alliance with the Egyptian Sawiris business dynasty to build 50,000 new homes in Cairo. Mr de Nicolas is one of a growing number of talented entrepreneurs making waves in countries that hitherto have not seen much entrepreneurship—a very different breed from the resource billionaires, the other face of today’s emerging-markets business. A new book by Tarun Khanna, “Billions of Entrepreneurs: How China and India are Reshaping Their Futures and Yours”, may be overstating the numbers, but the basic idea is right.

For example, in Nigeria, an economy now showing more hopeful signs than for several decades, oil and mining is a big deal, but so are consumer-oriented businesses such as media. Brazil has a large number of entrepreneurial start-ups with global ambitions in the clean-energy sector, for example. Fadi Ghandour, a Jordanian who has built Aramex into the “FedEx of the Middle-East”, sees entrepreneurship starting to take hold throughout that region as younger people realise that trading ideas may offer a better route to riches than land or oil.

Admittedly, venture capital is lagging behind other sorts of finance in establishing a presence in emerging markets. Yet almost everywhere in the developing world the outlook for entrepreneurs is far better than it was even five years ago.

The recent rise of the emerging markets has owed much to the combination of a benign global economy and relatively sensible policymaking at home. Neither of these can be taken for granted in the years ahead because at least three of the forces behind the recent economic boom no longer apply: strong American consumer demand, cheap money and cheap oil. Indeed, the latest trends in the world economy are highlighting significant differences (eg, in reserves of natural resources) between emerging economies that tend to be grouped together as if they were essentially homogenous.

School of hard knocks

In turn, this is putting the competence of economic policymakers in emerging markets to the test, with potentially big implications for the new champions. In commodity-rich Brazil, for example, the boom in natural-resource prices and the central bank's determination to be tough on inflation has made the *real* one of the world's strongest currencies. This has hurt Brazilian exporters such as the widely acclaimed new champion, Embraer, whose regional jets have proved an unexpected hit with airlines the world over. The reliance of India and China on imported oil, which their governments have long been subsidising for domestic consumers, may have nasty long-term consequences.

Yet the familiar emerging-market mix of volatility and bad economic policies may have been the making of the most talented bosses of emerging-market firms (admittedly not a large group), forcing them to concentrate on cutting costs, raising productivity and ensuring a strong cashflow. "Some managers from emerging markets have had to develop certain abilities that are proving very valuable when they go to a first-world economy, where productivity is crucial," says Antonio Bonchristiano of GP Investments, a big Brazilian private-equity firm. "Look at Lakshmi Mittal, who has done brilliantly in one of the world's most basic industries."

Another example is Carlos Brito, the Brazilian chief executive of InBev, a beer giant, which in July spent $52 billion on buying America's Anheuser-Busch to become the world's largest brewer. Like Mr Mittal, Mr Brito has a reputation as an effective cost-cutter. That said, few old multinational champions are likely to admit defeat as easily as Anheuser-Busch.

Ins and outs

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Acronyms BRIC out all over

IS IT time to retire the phrase “emerging markets”? Many of the people interviewed for this special report think so. Surely South Korea, with sophisticated companies such as Samsung, has fully emerged by now. And China already has the world’s fourth-largest economy.

The term “emerging markets” dates back to 1981, recalls the man who invented it, Antoine van Agtmael. He was trying to start a “Third-World Equity Fund” to invest in developing-country shares, but his efforts to attract money were being constantly rebuffed. “Racking my brain, at last I came up with a term that sounded more positive and invigorating: emerging markets. ‘Third world’ suggested stagnation; ‘emerging markets’ suggested progress, uplift and dynamism.”

Later in the 1980s the fast-growing economies of South-East Asia acquired the tag “Asian Tigers”—until they ceased to roar during the financial crisis of 1997-98. In 2001 Jim O’Neill, chief economist of Goldman Sachs, came up with the acronym “BRICs” for the next four countries it expected to enter the economic big league: Brazil, Russia, India and China. He says that the BRICs, Korea and Mexico “should not be really thought of as ‘emerging markets’ in the classical sense, as many still do. We regard these countries as a critical part of the modern globalised economy.”

In its search for definitive rigour, the FTSE group has come up with three categories for what used to be known as third-world economies: advanced emerging, secondary emerging and frontier markets (which have a stockmarket but perhaps not much else).

“Emerging markets are places where politics matter at least as much as economics to market outcomes,” says Ian Bremmer of Eurasia Group, a political-risk consultancy. That definition surely includes Russia. One Russian billionaire, after lambasting the “emerging” label as insulting, suggests using “high-growth economy” instead. Sounds good—but what if a recession comes along? That might call for a new tag: “submerging”.

The empire strikes back

Sep 18th 2008
From The Economist print edition

Illustration by James Fryer



Why rich-world multinationals think they can stay ahead of the newcomers

“YOU get very different thinking if you sit in Shanghai or São Paulo or Dubai than if you sit in New York,” says Michael Cannon-Brookes, just off the plane from Bangalore to Shanghai. “When you want to create a climate and culture of hyper-growth, you really need to live and breathe emerging markets.” Mr Cannon-Brookes is the head of strategy in IBM’s newly created “growth markets” organisation, which brings together all of Big Blue’s operations outside North America and western Europe. “This is the first line business in 97 years of our history to be run outside the US,” he says excitedly, noting that “Latin America now reports to Shanghai.”

IBM’s thinking about emerging markets, and indeed about what it means to be a truly global company, has changed radically in the past few years. In 2006 Sam Palmisano, the company’s chief executive, gave a speech at INSEAD, a business school in France, describing his vision for the “globally integrated enterprise”. The modern multinational company, he said, had passed through three phases. First came the 19th-century “international model”, with firms based in their home country and selling goods through overseas sales offices. This was followed by the classic multinational firm in which the parent company created smaller versions of itself in countries around the world. IBM worked liked that when he joined it in 1973.

The IBM he is now building aims to replace that model with a single integrated global entity in which the firm will move people and jobs anywhere in the world, “based on the right cost, the right skills and the right business environment. And it integrates those operations horizontally and globally.” This way, “work flows to the places where it will be done best.” The forces behind this had become irresistible, said Mr Palmisano.

This ambitious strategy was a response to fierce competition from the emerging markets. In the end, selling the personal-computer business to Lenovo was relatively painless: the business had become commoditised. But the assault on its services business led by a trio of Indian outsourcing upstarts, Tata Consulting Services, Infosys and Wipro, threatened to do serious damage to what Mr Palmisano expected to be one of his main sources of growth.

So in 2004 IBM bought Daksh, an Indian firm that was a smaller version of the big three, and has built it into a large business able to compete on cost and quality with its Indian rivals. Indeed, IBM believes that all in all it now has a significant edge over its Indian competitors.

Being willing to match India’s low-cost model was essential, but Mr Cannon-Brookes insists that IBM’s enthusiasm for emerging markets is no longer mainly about cheap labour. Jeff Joerres, the chief executive of Manpower, an employment-services firm, also thinks the opportunities for savings are dwindling. “When you see Chinese companies moving in a big way into Vietnam, you think there is not

much labour arbitrage left."

Perhaps a bigger attraction now, according to IBM, are the highly skilled people it can find in emerging markets. "Ten years, even five years ago, we saw emerging markets as pools of low-priced, low-value labour. Now we see them as high-skills, high-value," says Mr Cannon-Brookes. As for every big multinational, winning the "war for talent" is one of the most pressing issues, especially as hot labour markets in emerging markets are causing extremely high turnover rates. In Bangalore, for example, even the biggest firms may lose 25% of their staff each year. IBM reckons that its global reach gives it an edge in recruitment and retention over local rivals.

IBM also says it can manage the risk of intellectual-property theft—a perennial worry for multinationals in emerging markets, especially China—well enough to have cutting-edge research labs in India and China. And it is starting to "localise" its senior management, including moving its chief procurement officer and the head of its emerging-markets business to China. But as yet it has no plan to move its headquarters from Armonk, New York, whereas Halliburton, an energy-services firm, shifted its headquarters to Dubai last year. One notable success has been the company's partnership with AirTel in the Indian mobile-phone market, which it has already extended to other Indian phone companies and is likely to take to other countries. In this partnership IBM manages much of AirTel's back-office operations and shares the financial risk with the phone company. "We grow as they grow," says Mr Cannon-Brookes, noting that IBM is now the largest service provider to local customers in India.

Risk-sharing has worked well for other multinationals too. Vodafone, for example, is a big shareholder in Safaricom. In June Daiichi Sankyo, a Japanese pharmaceutical giant, bought a 51% stake in India's Ranbaxy Laboratories. Such deals increasingly involve strategic partnerships rather than the joint ventures of old. Daiichi hopes the deal will add value to its research and development expertise and provide access to Japan's fast-growing market to Ranbaxy, which in turn brings low-cost manufacturing and an understanding of the generics market.

In many emerging markets the most attractive potential customer is the government, thanks to an infrastructure boom that promises to span everything from mobile telephone networks to roads, airports and ports, energy and water supply. IBM is not alone in pitching directly to governments for this business, relying on its established brand and on the growing pressure on emerging-country governments—even those that are not strictly democratic—to deliver high-quality, value-for-money infrastructure. Instead of trying to sell specific products, they say, these firms aim to help governments draw up plans for improving their country—plans which invariably require substantial spending with the company concerned. Both Cisco and GE have recently started establishing long-term problem-solving relationships with governments in which the firms help to design an infrastructure programme as well as build some or all of it.

Buy my strategy

Three years ago Cisco combined all its emerging-markets activities into a single unit. Since then the share of its revenues coming from emerging markets has risen from 8% to 15%, accounting for 30% of its total revenue growth. "We identify the country's most important industries and go to them with a blueprint for a strategy to improve them using our technology to beat global benchmarks; this is about revolutionary not incremental change," says Paul Mountford, head of Cisco's emerging-markets business.

In 2006 GE—which since launching its Ecomagination strategy in 2003 has bet big on a boom in green technologies—signed a "memorandum of understanding" with China's National Development and Reform Commission to work jointly to safeguard the country's environment. It also wants to forge relations with local government in 200 second-tier Chinese cities, each of which will soon have a population of at least 1m and will need everything from a power supply to an airport.

More recently, top GE executives have got together with Vietnam's government to discuss the huge problems facing the country in water, oil, energy, aviation, rail and finance—all areas in which GE has products to sell. At one meeting GE's president found himself in the same room with no fewer than three Vietnamese leaders who had taken part in a leadership programme at GE's famous training facility in Crotonville, New York, recalls John Rice, the company's head of technology and infrastructure. This programme of inviting groups of 30-40 senior government and business leaders from a particular emerging country to Crotonville for a week was launched more than a decade ago, starting with a group from China. "We transfer a lot of learnings between us, and we end up friends for life," says Mr Rice.

Today's leading multinationals "are no longer the slow-moving creatures they used to be. They are not going to be beaten up like the big American companies were by the Japanese," says Tom Hout, a former consultant at BCG who now teaches at Hong Kong Business School. With Pankaj Ghemawat, who last year published a well-received book, "Redefining Global Strategy", Mr Hout has analysed the emerging market in which multinationals have competed longest against local champions: China. Whether the established multinationals or their local rivals are winning "depends on the segment you're looking at", says Mr Hout. Established Japanese and Western multinationals dominate in the high-tech sectors of the economy; the Chinese are strong at the low end. The main battleground is in the middle. This is quite different from the conventional wisdom, which is that established multinationals are getting pushed out by local companies, he concludes.

Illustration by James Fryer



A 2007 study by Accenture of China's top 200 publicly traded companies found that the best businesses in China are not yet on a par with the world's foremost ones. Although their revenue growth increased on the back of China's continued economic growth, their ability to create value was still only half that of their global peers. "It remains to be seen whether China's best players have built the management practices and supporting business operating models that will allow them to generate profitable growth in more mature markets over the long term," the study went on to say.

Their legacy thinking and cost structures notwithstanding, some established multinationals are increasingly trying to take on the frugal engineers of the emerging markets head-to-head, says Mr Ghemawat. "Smarter multinationals have all given up on the idea that they can simply deliver the same old products in the developing world," he explains. "If they just focus on pricing high in mostly urban areas, they will miss out on the mass consumer markets that are emerging. And they have to be able to compete as cost-effectively as the local firms, which can mean fundamentally re-engineering their products and business model."

A recent report by BCG, "The Next Billion Consumers", highlighted many innovative business models and products offered by multinationals such as Nokia— still the biggest mobile-phone producer in China, despite frequent predictions that it will fall behind a local rival—and Procter & Gamble, as well as similar efforts by emerging-market firms.

In search of excellent managers

The decisive factor may turn out to be management. Although some emerging-market firms are very well managed, by and large established multinationals still seem to have the edge. Mr Hout reckons that the expatriate managers now deployed by multinationals in emerging markets are generally of a much higher quality than the "young bucks or retirement-posting types" they used to send. "They are aggressive, smart, at the heart of their careers. And they tend to be married to more worldly women than management wives used to be."

That said, the multinationals' management advantage is based more on training and experience of running a large business than on exposure to other countries. Indeed, leading multinationals are reducing their use of expats, and those they do send are often expected to train a local manager as their successor. There is still a striking lack of executives from emerging markets at the top of developed-country multinationals. Even at GE, which is wholeheartedly committed to emerging markets, around 180 of the top 200 managers are still Americans. "The single biggest challenge facing Western multinationals is the lack of emerging-market experience in their senior ranks," says Mr Ghemawat.

Such companies' boardrooms are even less globalised. According to Clarke Murphy of Russell Reynolds, a recruitment firm, American multinationals now have a "ferocious interest in attracting non-Americans to the board", but as yet even Europeans are a rarity, let alone directors from emerging markets. The share of non-Americans on the boards of American multinationals is less than 5%.

The main problem "is attendance, especially if there is a crisis and the board needs to meet a lot at short

notice”. Once again, Goldman Sachs seems to have found a clever compromise by appointing Lakshmi Mittal to its board. The Indian steel tycoon is based in London and often visits New York, where the investment bank has its headquarters.

Some European firms are doing slightly better than their American counterparts at internationalising their boards. Nokia recently appointed Lalita Gupte, an Indian banker who had just retired from ICICI bank, one of the world’s most innovative practitioners of bottom-of-the-pyramid finance. And leading British companies have lots of foreigners in their executive suites and boardrooms.

Moreover, multinationals have great trouble retaining the managers they do have in emerging markets, says Mr Hout. “Well-trained, good, honest people are scarce in emerging markets. Multinationals are better at training these people than emerging-market companies, which prefer to poach them once they are trained.”

The founders of emerging-market firms are often impressive, but such firms typically lack the depth of management talent of old multinationals, says Mr Hout. The best students he has taught on MBA courses in Hong Kong and Shanghai have typically worked for developed-country multinationals.

Part of the problem in China is that running a big company—even a giant such as China Telecom, with its 220m customers—still has a lower status than a political job such as governor of a province. And Chinese managers, being used to protected markets, often lack the skill to operate in more sophisticated markets overseas.

Anil Gupta, co-author with Haiyan Wang of a forthcoming book, “Getting China and India Right”, says that recognition of their lack of management capability may have been one reason why no Chinese steel firms joined their Indian and Brazilian peers in the bidding war for Corus, and why no Chinese carmakers entered the battle to buy Jaguar and Land Rover. “If one could create a Jack Welch index of leadership and assess companies on such a measure, the top 50 companies from India would come out way ahead of the top 50 companies from China,” says Mr Gupta, a professor of strategy at the University of Maryland.

Certainly some Indian firms are extremely well run. The senior ranks of Tata, for example, are full of professional managers. On the other hand, many Indian firms are in family ownership, and “it can be hard to find room for professional managers when you have several sons demanding jobs of similar high status,” says Mr Ghemawat.

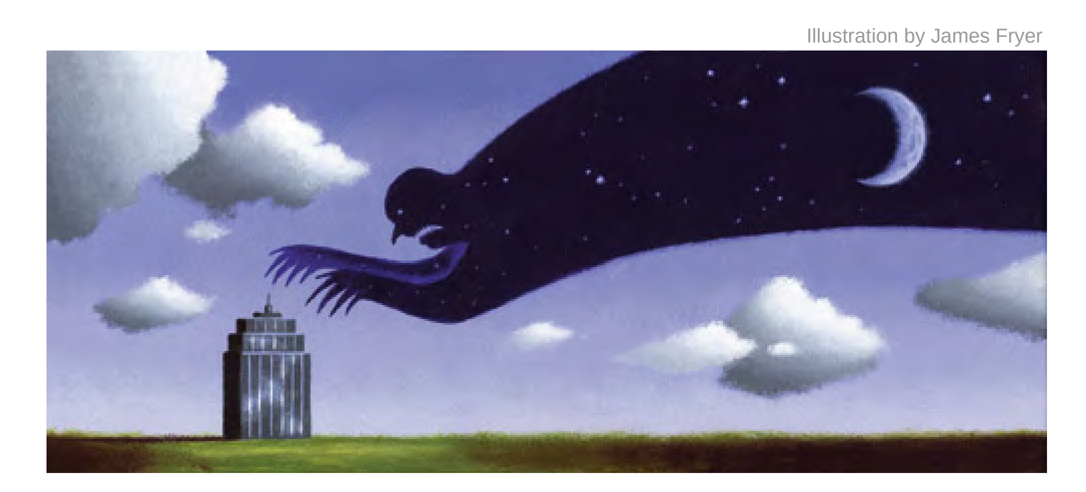
Perhaps the best-known example of the problems of family ownership is the feud between the Ambani brothers, who after their father’s death divided the family’s huge conglomerate, Reliance, between them. The dispute still simmers on. In July a bid by Reliance Communications, run by Anil Ambani, to buy a South African mobile-phone company was thwarted by Mukesh Ambani, the boss of Reliance Industries. No wonder that the brothers, who live in the same opulent apartment building, have separate lifts to avoid chance meetings.

Economist.com SPECIAL REPORTS

Oil, politics and corruption

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Illustration by James Fryer



Bad capitalism carries its own risks

TO MOST Western businessmen, this summer's hounding of Robert Dudley was clearly the work of the Kremlin. Never mind that the four billionaires whose court actions drove the British chief executive of BP-TNK out of Russia presented it as an ordinary business dispute over the terms of the oil joint venture, rejecting the idea that their origins in the Soviet Union made them Kremlin stooges. (One of them told a group of journalists in New York recently: "If you believe that the Kremlin likes me, you are very wrong. First, I am Jewish. Second, I am rich. Third, I am independent.") To the outside world, this was yet another reminder of the huge political risk involved in doing business in Russia.

Political risk is arguably more pervasive and fundamental to who makes or loses money than at any time since the second world war. And not just in Russia. Indeed, although political risk is most prevalent in emerging markets, it is not confined to them, as Dubai Ports World discovered in 2006 when it tried to buy some American ports from their British owner, P&O, only to be delayed in Congress. A year earlier the Chinese National Offshore Oil Company (CNOOC) had tried and failed to buy Unocal, an American oil company.

In 2006, when Lakshmi Mittal bid for Arcelor, a European steel firm, he met fierce and seemingly racist opposition from the governments of France, Luxembourg and Spain, which preferred to see their champion merge with a Russian rival rather than with "a company of Indians", as Arcelor's chairman put it. The deal went ahead only when India's government threatened a trade war.

"Developed-country governments do unexpected things that are every bit as troublesome as emerging-market governments. If you are an oil or gas company today, do you worry more about emerging markets or a windfall-profit tax in the US?" says GE's John Rice. Look, too, at the recent heavy-handed interventions in the financial system by the American government. Yet most business leaders around the world reckon that political risk is a far greater problem in emerging markets. Ask the boss of Carrefour, a French retailer, whose shops in China saw violent protests this year after pro-Tibet campaigners disrupted the progress of the Olympic torch through Paris.

Western oil and mining companies, having started to improve their behaviour in Africa under pressure from NGOs, now face competition from Chinese, Indian and Russian rivals that seem willing to cut deals with even the most unsavoury African politicians. And how do Western firms compete in countries where bribes are seen as an ordinary cost of doing business?

Then there are the more humdrum uncertainties about emerging-market governments' attitude to the rule of law. Will theft of intellectual property be punished? Will lax regulatory enforcement allow your company's supply chain to be contaminated? (For example, Whole Foods Market discovered in July 2008 that Chinese powdered ginger it had been selling as organic contained a banned pesticide.) Might the government issue a decree that alters the fundamentals of your business, without consultation or

recourse, as often happens in China? Will it decide suddenly to break up local monopolies, or alternatively encourage their formation?

On top of all this, there is the traditional game of guessing whether governments will abandon sound fiscal and monetary policy at the first sign of economic turbulence—ie, any day now. The leading multinationals insist that emerging markets are now so important to their long-term growth prospects that they have to be in them regardless of short-term macroeconomic policy risks. Gone for ever, they insist, is the shortsighted old habit of rushing into emerging markets as they get hot, and out again at the first whiff of trouble.

East, west, which is best?

There is not much consensus among leading businesspeople about the political risks of different emerging economies, though they agree that there are huge differences, even within the BRICs. However, Brazil (by far the richest of the four by income per person) is widely seen as remaining on the up, with the next president expected to continue with or improve on the country's current macroeconomic policies, and all the benefits of lively private and public equity markets, well-run big companies (Vale, Petrobras, Embraer and so on) and an increasingly innovative and entrepreneurial economy.

Some of the biggest disagreements are over Russia. "It's very risky, but it is also very profitable, especially if the Kremlin likes you," says another of the billionaire investors in BP-TNK. "They like the Germans, are afraid of the Chinese, don't like the Americans and British, don't mind the French." Foreigners should probably avoid industries that the Kremlin deems strategic, but which are they? Oil and mining, certainly, though that is also where the biggest opportunities lie. Technology, commercial aviation, telecoms, chemicals and agriculture are all "grey areas", says Ian Bremmer of Eurasia Group.

What about property? Hank Greenberg, the former boss of AIG, is investing in commercial property in Russia because, he says, it is "not a strategic industry" for the government. But Gary Garrabrant, chief executive of Equity International, who has been investing in emerging markets since the mid-1990s with Sam Zell, a property billionaire, is avoiding Russia "because we can't get our arms around the risk". Nor is he particularly impressed with India, where there is a "culture of institutionalised corruption around obtaining land and permits for development". As for China, "there is a huge opportunity in urbanisation, but stay diverse, below the government's radar. Don't be a target."

The growing importance of emerging markets has provided plenty of work for advisers on political risk from Cambridge Energy Research Associates to Oxford Analytica. "The extractive industries, firms like Shell, got the message about political risk 30 years ago, but most of the *Fortune* 100 weren't thinking this way until recently," says Mr Bremmer. "Corporates in the tech area are among the worst, perhaps because their management is suffused with engineers."

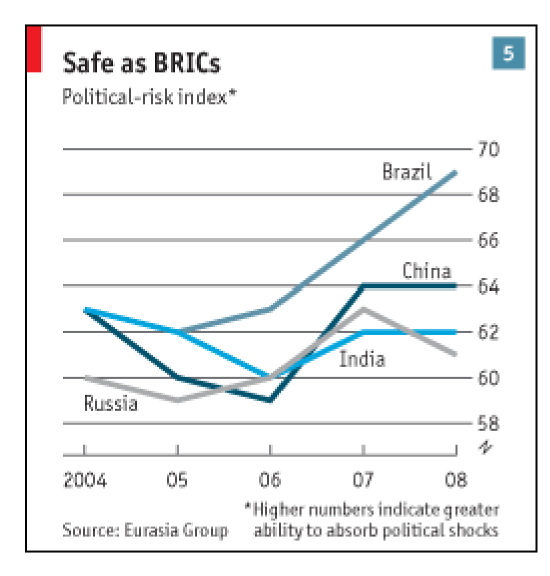
Is the political context for business in the emerging markets likely to improve? Tom Hout is encouraged by the experience of Cummins Engine in China. The American maker of diesel engines has done very well in the high-performance segment of the market, but has missed out on diesel vehicles lower down the scale that fail to comply with local rules on emissions. Now, in the more sophisticated cities, "a higher-quality civil servant has started prosecuting trucks billowing smoke," so these trucks are being replaced with better ones, using engines made by Cummins and other firms from developed countries.

In a similar vein, as Chinese firms get better at developing intellectual property, they are starting to seek protection for it in court. This has meant that IP rights are being taken more seriously, which should benefit foreign firms too.

NGOs are beginning to spring up throughout the emerging markets, demanding higher ethical standards of business and political leaders. In Africa, for instance, much of the initial pressure for better governance and less corruption came from developed-country NGOs. But now some African NGOs too are starting to challenge bad capitalism. One example is China-Africa Bridge, an NGO based in Beijing, founded by Hafsat Abiola, daughter of a former Nigerian president, to improve the effect of Chinese business on Africa, especially in resource industries. "For Africa, China's involvement will create winners and losers, but currently it will too often be African individuals who win, not communities and countries," she says. In particular, there have been many reports of unethical dealings between Chinese resource firms and leaders and officials of some African countries, including Sudan.

Ms Abiola's goal is to encourage China to do as it would be done

by in Africa. When companies such as Microsoft arrived in China, the government required them to invest in a lot of infrastructure and R&D to foster the country's own development, she says, "but as China comes to Africa, it is not being required to transfer knowledge or skills or promote local jobs." Though China is certainly building a lot of infrastructure—presumably to help it procure all the natural resources its firms are gobbling up—it often brings in its own people to do the work.



As developed-country multinationals enter emerging economies, it is crucial they do not lower their standards on corruption, says Ben Heineman, a former GE general counsel who recently published a book, "High Performance with High Integrity". "Are these multinationals going to be good corporate citizens, to increase the credibility of globalisation?" he asks. Besides anything else, he argues, behaving consistently ethically is in their self-interest. Successful global companies need uniform global cultures, in which everyone adheres robustly to the same rules, even in places where the local companies do not. If people in one part of the company start adopting a lower ethical standard, it can have a corrosive effect on the entire corporate culture.

This may be why the global expansion of emerging-market champions is a good thing. As they increasingly operate in developed countries, where corruption is much less acceptable, they will have to abide by their host countries' standards. That will create pressure within these firms to raise their standards back home.

Doing well by doing good

In the early 1990s, when GE decided to adopt uniformly high ethical standards throughout the firm, "we accepted it was a cost, but that the benefits outweighed it. Siemens reaped the whirlwind on that," says Mr Heineman. (In 2007, Peter Solmssen, one of his protégés, moved to GE's German rival as general counsel to sort out a huge bribery scandal that had brought down Siemens's chief executive.) GE embarked on this course after the American government started to enforce its Foreign Corrupt Practices act more vigorously, and other American firms asked it to lobby against the law. Instead, "we said, level up, not down," says Mr Heineman. At times when corruption was especially rife, GE pulled back in Nigeria and Russia, he notes. The company also provided some early funding to Transparency International, an anti-corruption NGO.

GE's Mr Rice reckons that the firm's hard line on corruption is actually helping it win business in many developing countries. This may be because ethical standards are rising—or, at a minimum, fear of public reaction to low ethical standards is rising—in at least some emerging markets. Country leaders feel under growing pressure to deliver better infrastructure and to be seen to be doing the best they can, says Mr Rice. Increasingly, "they understand that corruption is a barrier to improving the standard of living of the poorest people, and they want to do business more and more with an ethical firm."

But there are plenty of governments that are not striving for good capitalism. Oil-rich Russia, for example, feels it can use Gazprom, its giant energy company, as an instrument for its geopolitical strategies, by threatening to turn off supplies to neighbouring countries that depend on them. And as emerging-country governments accumulate huge foreign reserves and start to invest them abroad through sovereign-wealth funds, developed countries fear that capitalism will become increasingly politicised everywhere.

The rise of state capitalism

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Coming to grips with sovereign-wealth funds

Illustration by James Fryer

"GOING overseas: a wrong investment decision," thundered Wu Zhifeng on his blog, "The Invisible Wings". He was furious about the performance of the $3 billion investment by China Investment Corporation, a sovereign-wealth fund established by the Chinese government, in shares of Blackstone, an American private-equity firm. Blackstone's shares have plunged since its flotation in June 2007, reducing the value of CIC's stake by $500m.

The Chinese government's policy of "going out"—investing abroad through its companies and new sovereign-wealth funds instead of at home where it was needed—was about showing off to the world, wrote Mr Wu: "Chinese companies started acquiring businesses here and there in the world so that many countries would shout that 'the dragon is coming'."

If some sovereign-wealth funds are unpopular at home, they are viewed with even more hostility in the rich world, where CIC and others have been splashing their cash lately. Such funds have provided several top Wall Street firms (as well as some of their European rivals) with large injections of cash in the past year—including Citigroup, which received $7.5 billion from the Abu Dhabi Investment Authority (ADIA). That probably saved a few of them from bankruptcy or a Bear Stearns-style forced sale, but it was controversial.

It is not just banks that have caught the sovereign-wealth funds' eye. In July the Abu Dhabi Investment Company bought a 90% share in New York's iconic Chrysler Building. Soon after that, Mubadala, another Abu Dhabi fund, announced that it intended to become one of GE's ten biggest shareholders (see article).

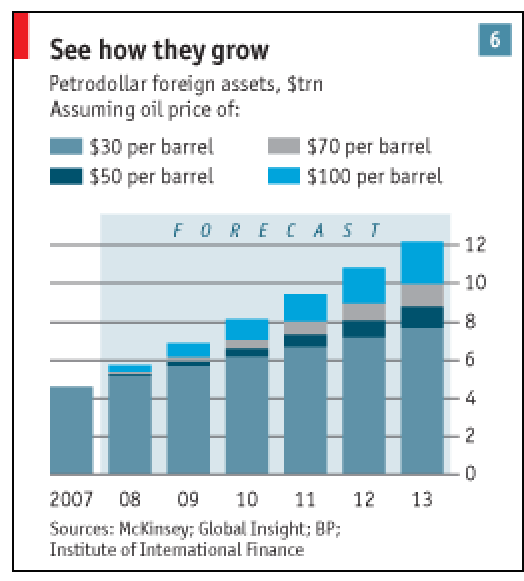
Public criticism of sovereign-wealth funds has subsided a little as the crisis in the developed world's financial markets has made people grateful for any money they can get. Yet in private there are plenty of worries about the growing size and power of sovereign-wealth funds.

In an article in the *Financial Times* last year, Larry Summers, a former American treasury secretary, wrote that a "signal event of the past quarter-century has been the sharp decline in the extent of direct state ownership of business as the private sector has taken ownership of what were once government-owned companies. Yet governments are now accumulating various kinds of stakes in what were once purely private companies through their cross-border investment activities." Mr Summers called for a new policy: "Governments are very different from other economic actors. Their investments should be governed by rules designed with that reality very clearly in mind."

The problem, if problem it be, may be just beginning. According to the US Treasury, sovereign-wealth funds are "already large enough to be systemically significant". But the McKinsey Global Institute in a recent report forecast a dramatic increase in the assets of sovereign-wealth funds over the next few years. It predicts that Asia's sovereign assets, which at the end of 2007 stood at $4.6 trillion, will rise to at least $7.7 trillion by 2013 on conservative growth assumptions, and to as much as $12.2 trillion if economic growth continues at the fast pace of the past seven years.

As for the sovereign-wealth funds of oil-rich states such as Russia, the United Arab Emirates and Saudi Arabia, much depends on what happens to the price of oil. McKinsey looked at the impact of several possible average oil prices over the next five years, all below what the stuff has been selling for in recent months. Even at $50 a barrel (remember?), the assets of these

sovereign investors will rise to $8.9 trillion by 2013, from $4.6 trillion at the end of 2007 (see chart).



For good or ill

What are they going to do with the money? Will these funds become instruments of a "new mercantilism", with the controlling government attempting "to ensure that company-level behaviour results in country-level maximisation of economic, social and political benefits", as Ronald Gilson and Curtis Milhaupt suggest in a recent article in the *Stanford Law Review*? Will they be opportunistic, as Larry Summers fears? Will they be politically aggressive, as Russia has already shown itself with Gazprom (not, strictly speaking, a sovereign-wealth fund but certainly a well-endowed corporate arm of the state)?

Or are the funds simply investors, looking for nothing more sinister than a decent return on their money? Earlier this year, Yousef al Otaiba, Abu Dhabi's director of international affairs, in an open letter to America's treasury secretary, said that "it is important to be absolutely clear that the Abu Dhabi government has never and will never use its investment organisations or individual investments as a foreign-policy tool." And as Messrs Gilson and Milhaupt note briefly in their article, despite fears that sovereign funds will use their investments to secure technology, gain access to natural resources or improve the competitive position of their domestic companies, "no one can point to a reported incidence of such behaviour."

In fact, there is no such thing as an average sovereign-wealth fund. Some are new, like China's; others have been around for decades, such as the Kuwait Investment Authority (KIA), set up in 1953. They vary greatly in size: the biggest is ADIA, which with assets of $625 billion is almost double the size of the next-biggest, Norway's. Some, like the KIA, are essentially passive portfolio investors. Others are more active, resembling private-equity firms (Dubai International Capital) or even industrial holding companies (Singapore's Temasek). Most of them are increasingly shifting their focus to equity-investing. Many of them also invest in hedge funds and private-equity firms.

There are big differences, too, in their willingness to use professional managers and in their competence as investors. One reason why CIC bought its stake in Blackstone, and Mubadala its stake in Carlyle, may have been to tap the investment expertise of those firms. Another way of raising the quality of in-house staff is to appoint nationals who have gained qualifications abroad.

Singapore's Temasek is much admired by other sovereign-wealth funds for its investment nous and its effective corporate governance, and is thought to be seen as a role model by the Chinese. The deepest reserves of talent are at ADIA, says a veteran partner at a big American private-equity firm who has worked with many of the sovereign-wealth funds. However, some of its top managers have been taken by a new body, the Abu Dhabi Investment Council, set up a couple of years ago.

At the other extreme is the Qatar Investment Authority, which the private-equity veteran says is "always teaming up with the wrong people and operating a highly idiosyncratic management style". The QIA's ill-fated attempt to buy Sainsbury's, a British supermarket chain, may alone have lost the fund over $2 billion, he calculates.

Russia and China may be exceptions, in that both their governments have been willing to use the companies they own to pursue political goals and might well try to do the same with their sovereign-wealth funds. If that starts to happen, they may need to be governed by different rules from those applying to funds that try to concentrate mainly on getting good investment returns.

Many sovereign-wealth funds have been upset by the criticism they have received over their recent Wall Street investments. America's treasury secretary, Hank Paulson, is understood to have spent a lot of time reassuring them, especially about the reaction to their investments in Wall Street, after Merrill Lynch, Morgan Stanley and others persuaded the funds to shore them up. "They have lost money and then been subjected to complaints in Congress about the lack of transparency on their balance sheet or their agenda," says the private-equity veteran.

To try to reduce the criticism, the IMF has been working on guidelines for sovereign-wealth fund

transparency, due to be agreed on at its autumn meetings in Washington, DC. As things stand, transparency ranges from next to none to a lot. Again, some sovereign funds protest that they are being subjected to far tougher disclosure rules than many big domestic investors in developed countries. It will be no surprise if the IMF proposals are given a lukewarm reception and then largely ignored.

“There is a huge amount of hypocrisy about sovereign-wealth funds in the West,” says Richard Cookson, a global strategist at HSBC who keeps an eye on sovereign-wealth funds. “When did the developed world ever not use its economic and political clout to buy assets on the cheap?” In the Asian crisis of the 1990s, American banks bought into several troubled Asian banks. When local politicians complained, America accused these countries of protectionism, says Mr Cookson. The real reason the developed world is now so upset, he suspects, is that the sovereign-wealth funds symbolise so clearly the shift in the balance of economic power to the emerging markets.

Yet when emerging countries set up sovereign-wealth funds, with separate governance and a clear investment mandate, it is often a sign of them “recognising that they got it wrong in the past, asking how to improve, and concluding that an endowment/portfolio approach is the best way,” says Chuck Bralver of the Centre for Emerging Market Economies at Tufts University. “Leaving the Russians aside, they are mostly being highly professional.” Even the Chinese sovereign-wealth funds are expected to hire hundreds of professional investment managers, mainly from developed countries.

Known unknowns

What is certain is that as sovereign-wealth funds grow, which they are bound to do, an increasing number of the world’s companies will end up at least partly in state ownership. And there is a possibility that the sovereign-wealth funds’ good behaviour is a Trojan-horse strategy which in time will give way to mercantilist interference.

In practice, sovereign-wealth funds so far have given little cause for alarm. Their biggest downside may be that they lack the capacity to find a sensible home for all the money that is likely to be flooding in over the coming decades, and that much valuable capital will be squandered on ill-advised projects.

“I’m struck by how responsibly China and countries in the Middle East are behaving,” says Laura Tyson, who used to chair Bill Clinton’s Council of Economic Advisers and now teaches about emerging markets at Berkeley. The Gulf states are trying to use their wealth to generate “higher living standards over the next 100 years, not squandering it on the high life like they did in the 1970s”. Despite much talk about their desire to switch to the euro or even make it the next reserve currency, “they are not dumping the dollar, they are continuing to make long-term investments,” she points out. Indeed, bailing out the developed world’s banking system seems heroically generous of them.

All of which, says Ms Tyson, “underscores the extent to which emerging markets now recognise that their well-being depends on the stability of the international system.” Forms of state ownership will become more common, she concedes, “but so what? The simple dichotomy between private and state-owned does not tell us very much at this point.”

To be on the safe side, Messrs Gilson and Milhaupt propose that shares in American firms that are bought by sovereign-wealth funds should have their voting rights suspended until they are sold again. This would beef up existing arrangements that protect American firms from foreign ownership where national security is seen to be threatened. Without the voting rights, the sovereign investors could not interfere in the activities of the firms they buy, but if the suspension is only temporary, the funds would not suffer any financial penalties.

This looks like an elegant solution, but it is not clear if it could be enforced. Moreover, it would make sense only if there really is reason to worry about the intentions of sovereign investors. If their intentions

are good, the proposal would rob capitalists of their ability to play a value-creating role in the governance of the firms they invest in.

“We need to reconsider what is the best way to organise large-scale entities playing in global markets,” observes Ms Tyson. After all, in recent years it has become clear that free-market public ownership of companies can give rise to conflicts of interest and principal-agent problems, which led to the rise of private equity as a partial solution. Perhaps well-motivated, well-run sovereign-wealth funds with long-term investment horizons could help create a more effective system of corporate ownership than today’s often short-termist investors. Let’s hope so.

Cities in the sand

Sep 18th 2008
From The Economist print edition

A new sort of investment partnership

THE deal between GE and Mubadala concluded in July provides a useful test case of whether the rise of sovereign-wealth funds can be good for capitalism. Currently, both the company and the investor are claiming they have gained.

There is no doubting the ambition of the Gulf states as they set about building brand-new cities in the desert. Dubai has already become a cross between Las Vegas and pre-strife Beirut, with its luxury hotels, international financial centre, leisure and shopping facilities and man-made islands. But Abu Dhabi, its richer neighbour-cum-rival, has ambitious plans of its own, bringing in the sort of high culture Dubai lacks (including outlets of the Louvre and Guggenheim) and even looking beyond the oil age by committing $22 billion to building a futuristic carbon-free city called Masdar.

Masdar is one of the key ingredients of the deal, in which Mubadala agreed to become one of the firm's top ten shareholders. GE will invest heavily in Masdar to make it a showcase for its Ecomagination clean-energy programme. The firm and the sovereign-wealth fund will also put $4 billion each into a joint venture to provide commercial finance in the region. Ultimately, the two are expected to invest a total of $40 billion in the partnership.

GE's strategy is to establish bases in cities throughout the Gulf, investing in things that are useful both to the city and to the region. It also has close relations with Saudi Arabia, which it has made into its regional infrastructure-services hub. Saudi Arabia is building six new "economic cities", in the hope of providing jobs that it desperately needs. It is trying to tempt energy-intensive international firms to move there with the promise of cheap fuel—which may not be such a boon for the environment.

The Mubadala deal represents the latest stage of a relationship that has continued to deepen since the fund's managers visited Crotonville in 2005 for a week's leadership training. GE says it is betting on a new generation of leaders in Abu Dhabi—and indeed across the Middle East—who are committed to building a more sustainable economic foundation that will survive the depletion of their oil and gas reserves. Mubadala, which also has a 7.5% stake in Carlyle, a big American private-equity firm, says that as a long-term investor it is keen to take big positions in such world-class companies. That must make Jeffrey Immelt, GE's embattled boss, feel more secure in his job.

Opportunity knocks

Sep 18th 2008
From The Economist print edition

As long as the protectionists don't spoil it

Illustration by James Fryer

"WE CAN only be defined as global," says Lakshmi Mittal. "We are not Indian, or French, or from Luxembourg. Among the top 30 managers of Arcelor Mittal there are nine different nationalities." The Indian-born steel tycoon is convinced that he is building a truly global company, transforming an industry that was manifestly failing to deliver while it was organised along nationalist lines. Not so long ago every country felt it had to have its own steel giant, even if it was government-owned and losing a fortune.

Steel was also the first Western industry to go into decline, he points out—and by extension, though he does not say it, the first to be revived by a company started in a developing country by a businessman from an emerging market (albeit one who has long been based in London). He wants his "customers to be able to buy our product anywhere in the world at the same quality". He wants to recruit the best talent in the world, and has established Arcelor Mittal University in a grand old building in Luxembourg to help him do that.

He is measuring the firm against the world's most admired companies—GE on human resources, leadership and purchasing, Royal Dutch Shell on IT. He sounds like a misty-eyed internationalist when he describes the "seamless discussion the management team has on any subject—you would not think there are different nationalities in the room." In sum, "I want to create a truly great global company."

Can he do it? Some leaders in the less emerged countries where his firm operates may see how well he has done with the rubbish they thought they had sold him and demand their pound of flesh. Perhaps the policy of vertical integration which is prompting Arcelor Mittal to buy mines and energy producers at today's high prices will prove to be misplaced. But a bigger threat is what the world's governments may do next.

Think abundance

In particular, how will these governments choose to mix the various models of capitalism described by Messrs Baumol, Litan and Schramm in "Good Capitalism, Bad Capitalism"? Ominously, the governments of some of the bigger emerging economies—notably Russia and China—seem bent on a mixture of state-led and maybe oligarchic capitalism, rather than the potent blend of big-firm and entrepreneurial capitalism that has served America, Britain and other rich countries so well.

Should the rich world worry about it? There is no evidence so far that sovereign-wealth funds are trying to wield inappropriate influence in the companies they invest in. One day they might, but until then they probably deserve the benefit of the doubt. The most plausible scenario is that the growth of sovereign-wealth funds, along with other possibly mercantilist forays by emerging-country governments, will simply waste a lot of capital. However unfortunate, that would be largely a matter for them. Besides, some governments, even undemocratic ones, seem to understand that it is in their interests to move in the direction of wealth-maximising good capitalism rather than squander their country's wealth, since it is their citizens who will ultimately pick up the bill.

It is reasonable to worry about the activities of, say, Chinese resource firms in some African countries, which are thought to have shored up some of the continent's worst leaders—though it is hard to see how

this can be changed other than by reforming the governance of these African countries themselves. Likewise, policies in emerging countries that allow corruption, cronyism and local monopolies or treat foreign multinationals unfairly are certainly undesirable. But in neither case is protectionism the answer.

The rise of protectionist sentiment in developed countries is a serious cause for concern. As Messrs Baumol, Litan and Schramm observe, capitalism is a dynamic force and can change over time—including from good forms to bad. Just because America, in particular, has long been a force for good capitalism does not mean that it will continue that way.

Arguments for protectionism are based on fears that are wholly at odds with the evidence. The experience of recent years does not support the idea that millions of jobs will be outsourced to cheap foreign locations. Nor, as so-called techno-nationalists claim, is it likely that innovation will shift from America and the rest of the developed world simply because Microsoft and IBM have set up R&D centres in India and China, as they and the new champions start to make better use of all the clever engineers produced by those countries' education systems. As Amar Bhidé of Columbia Business School argues in his new book, "The Venturesome Economy", it is in the application of innovations to meet the needs of consumers that most economic value is created, so what matters is not so much where the innovation happens but where the "venturesome consumers" are to be found. America's consumers show no signs of becoming less venturesome, and its government remains committed to the idea that the customer is king.

Except, that is, when it comes to protectionism, which will hurt American consumers as well as slow the rise of the emerging markets and hence the escape of millions of their citizens from poverty. Far better to engage the emerging markets in the global economy and help them understand why it is to everyone's benefit to promote the good models of capitalism, not the bad.

Mr Mittal, for one, remains optimistic. "There is currently an anxiety in the developed economies that is the opposite of the enthusiasm in the emerging markets—but in ten years a lot of the anxiety will go away and we will see a lot closer partnership and collaboration," he says. "I don't think we can really block globalisation."

The final word should go to an American, albeit one who works for a Chinese firm. Lenovo's Mr Amelio sees strong parallels between the challenge raised by the new age of globality and the cultural challenges his own firm initially faced, especially its American workers' suspicions of their new Chinese colleagues. The root of the problem is a "scarcity mentality in which people see things as a zero-sum game", he says. "Instead, we need an abundance mentality that believes everyone can become better off."

Sources and acknowledgments

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Sep 18th 2008
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Airlines and the credit crunch

Shredding money

Sep 18th 2008
From The Economist print edition

Lower oil prices have revived airlines' shares, but they are still in trouble

Illustration by David Simonds



THE airline industry dodged two bullets this week. The rescue of AIG, once the world's biggest insurer, also saved its subsidiary, ILFC, a market leader in aircraft-leasing. As a result 900 planes did not fall into the hands of the receivers, which would have caused confusion and disruption to dozens of airlines around the world. The second escape has been the lower oil price, which sent shares in America's beleaguered carriers soaring, despite the turmoil on Wall Street. But high oil prices had already turned last year's combined second-quarter profits of $2.4 billion for the six biggest carriers into losses of $1.77 billion. Only Northwest and Delta (which are soon to merge) stayed in profit. And with the world economy faltering the easing of the oil price provides only scant relief. Many airlines have been sheltering from three-digit oil in hedges that will soon unwind, exposing them to market prices.

At least 30 airlines have gone bust this year, and IATA, the industry's trade body, reckons its 230 members will lose about $5.2 billion in total, having made a rare collective profit of $5.6 billion in 2007, following $40 billion of losses since 2001. It is not just oil that has piled on the pressure. Investors got tough with struggling carriers as credit tightened. So the industry that survived assaults from terrorism and SARS is being undermined by the financial crisis.

Willie Walsh, chief executive of British Airways (BA), thinks that 30 more airlines will go under by the end of the year. He expects BA's fuel bill this year to jump by £1 billion ($1.8 billion), enough to wipe out last year's profits of £883m. Despite the fall in oil prices, he said this week, the industry crisis would be "deep and protracted".

New airlines have been hardest hit. Three offering cut-price premium services across the Atlantic—MAXjet, Eos and Silverjet—were early casualties, and another transatlantic newcomer, Zoom, quickly went into bankruptcy this summer. Aloha and ATA went bust in America, and Oasis, Hong Kong's long-haul start-up, folded too. This month XL, a European holiday firm that mainly sold flights, collapsed when its Icelandic investors pulled the plug.

Futura, a Majorcan charter airline, has stopped flying, and Lufthansa stepped in this week to rescue Brussels Airlines, the airline formed from the wreckage of Virgin Express and Sabena, Belgium's flag-carrier. SAS, the Scandinavian group, has also offered itself to Lufthansa. SAS has been trying to offload Spanair, its Spanish unit—a task rendered more difficult by the crash of a Spanair flight in Madrid in August, in which 154 people died. Spanair, Sky Europe and Air Berlin are said by analysts to be most at risk, along with Alitalia, which has been on life-support for at least two years.

Italy's bankrupt flag-carrier could be Europe's biggest casualty: this week the government was struggling to save it as ENI, an oil giant, threatened to cut off its fuel supplies. Earlier this year Alitalia seemed poised to participate in the consolidation of European airlines: Air France-KLM made a bid for it, but the deal fell through when unions denounced it and Silvio Berlusconi, then in opposition, made an election pledge to keep the airline in Italian hands. Mr Berlusconi, now prime minister, has since produced a plan to split up Alitalia. The state would take on the bad part—the debt and the unwanted workers—and a group of Italian businessmen would invest €1 billion ($1.4 billion) in a new, debt-free airline, to be merged with Air One, another Italian carrier.

As *The Economist* went to press the bail-out was still in doubt; investors were haggling with Alitalia's unions. The investors want the workers to give up privileges and accept pay and conditions in line with the rest of the industry. By mid-week some unions had agreed to a new contract, but pilots and cabin crew were still holding out.

If they can pull off a deal, the investors, who have formed a consortium called Compagnia Aerea Italiana (CAI), led by Roberto Colannino, the boss of Piaggio, a scooter firm, have a lot going for them. The new airline would be free of the government interference that has plagued Alitalia in the past. Thanks to Air One, it would have a more modern fleet than the old airline, which has ageing MD-80s that cost 40% more to fly than modern planes. The elimination of competition between Alitalia and Air One could also boost prices and profits on busy routes such as Rome-Milan.

Yet in bucking the trend towards consolidation and greater scale, the new company would be vulnerable, given its small size and its focus on short- and medium-haul flights. These days, airlines make their money on international long-haul routes. "Alitalia cannot survive in the long run as a stand-alone national airline because it lacks economies of scale," says Nick van den Brul, transport analyst at BNP Paribas.

Overall, says an Italian businessman who was approached as a potential investor in the new Alitalia, the venture represents a highly risky investment. The 15-20% potential return promised by Intesa Sanpaolo, the bank which devised the rescue plan, is not a sufficient reward for investing in an industry in such dire straits, he says. And some investors may have other motives: Intesa Sanpaolo, for instance, has a big lending exposure to Air One, which is heavily indebted. The loan would be safer if Air One merged with Alitalia.

If a deal with the unions can be done, Mr Colannino will try to strike an alliance with a larger European airline to serve international routes. Both Lufthansa and Air France-KLM are talking to CAI; the latter is said to be the favourite. But if the unions scupper the deal, Alitalia's demise would be the most spectacular of all the airlines that have fallen to earth this year.

Airlines

Under the hammer

Sep 18th 2008 | NEW YORK
From The Economist print edition

JetBlue finds a novel way to perk up its sales: selling tickets on eBay

COLLECTORS and bargain-hunters have long been devotees of eBay, but the online auction site may have won a new group of converts. On September 8th JetBlue, America's eighth-largest airline, put 300 tickets up for sale on eBay, with prices starting at five cents. Bidders snapped them up. Might this be a new way for struggling airlines to fill their planes?

The auction, which ended on September 14th, took place during a particularly slow period for the travel industry. September and October are never busy months, but America's economic woes mean flights are expected to be emptier than usual this year. By offering tickets (with fixed routes and dates) on eBay, JetBlue hoped to attract leisure travellers who had not considered going away this autumn, or did not know that JetBlue flew on certain routes. The company also auctioned package holidays with secret destinations, betting that the aura of mystery would bring in bids. (It did.)

On average, buyers paid 40% less for tickets sold at auction than they would have done at jetblue.com. But not all customers walked away with savings. Perhaps because of the novelty of the auction, or the competition that eBay auctions often foster, some paid more for flights and holidays than they would have done on the airline's website.

Of course, given the small number of tickets on sale, JetBlue's auction was chiefly a marketing stunt. Many bidders were frequent eBay users who stumbled on the offer while perusing the site. The auction also brought 135,000 people to JetBlue's website to find out more about the promotion. JetBlue says it will consider staging another auction in future. Big carriers such as Delta and United Airlines are unlikely to mimic this quirky marketing scheme, but smaller airlines such as Southwest might follow suit, if only to burnish their reputations as scrappy, innovative companies.

Could JetBlue's auction encourage industries other than airlines to use eBay? Richard Zeckhauser, a professor of political economy at Harvard's Kennedy School who has studied eBay closely, says firms that sell time-sensitive items, such as hotel-room or restaurant reservations or theatre tickets, might also try using the auction site to increase sales. But trying to sell an investment bank on eBay would probably be going too far.

Newspapers in America

Slim hopes

Sep 18th 2008 | NEW YORK
From The Economist print edition

A billionaire makes a surprising investment in the New York Times

IT SAYS a lot about the mood in American business today that an investment by a Mexican tycoon in the *New York Times* is widely regarded as good news. The realisation that beggars cannot be choosers has weakened the usual protectionist impulses, at least in the case of the recent purchase of 6.4% of the Gray Lady by Carlos Slim. Instead of bashing the Mexican telecoms billionaire for buying a piece of a great American institution, there has been relief that such a shrewd businessman is prepared to give a vote of confidence to an ailing firm in a deeply troubled industry.

Mr Slim is not alone in his confidence. Until they were hit by this week's stockmarket plunge, shares in the New York Times Company—which also owns the *Boston Globe,* among other newspapers—had risen by around 20% from their low in July. Perhaps that was due to speculation that a bid for the company was imminent. But there is no evidence that the Ochs-Sulzberger family wants to sell its controlling stake, and it is not riven with the intergenerational conflicts that led the Bancroft family to capitulate to Rupert Murdoch's bid for Dow Jones last year.

As for Mr Slim, his interest in the *New York Times* is said to be that of a passive investor who has seen the opportunity to invest in a great brand at an attractive price. Hence the sighs of relief at the paper's swanky new Manhattan headquarters. Yet is this really the time for investors to return to the American newspaper industry—which in recent years has been almost as good a way to squander money as buying shares in an investment bank?

When the restructuring of the industry caused by the rise of the internet is finally over, the *New York Times* will surely be one of the surviving brands. Yet it may have plenty of pain to go through before then. There are early signs that the decision to give seats on the firm's board to representatives of two activist hedge-funds, Harbinger Capital and Firebrand Partners, has led to a greater focus on cost-cutting. Following recent job cuts, the latest cost-saving wheeze is combining the previously separate business and sports sections to reduce printing costs.

Yet such savings are small compared with the impact of the paper's falling circulation—down 3.9% year-on-year according to the latest figures—and a sharp deterioration in the advertising market as America's economic gloom deepens. Gannett, America's largest newspaper company, highlighted how severe conditions have become when it revealed a 17% year-on-year decline in advertising revenues on September 15th. True, many other papers are in worse shape than the *New York Times*. Its feisty local rival, the *New York Sun*, is reportedly in danger of being closed. And McClatchy, America's third-largest newspaper company, announced a wave of job cuts on September 16th. Its debt is now distressed, and the company is cutting its dividend in half as it tries to stay out of the bankruptcy courts.

Meanwhile Mr Slim's fellow billionaire, Sam Zell, who bought the Tribune group (which owns the *Chicago Tribune* and *Los Angeles Times*, among others) last year, is firing lots of journalists and trying to raise money by selling assets such as the Tribune building and the Chicago Cubs baseball team, in a market where it is hard to get a good price for anything. Still, Mr Zell is not letting this get him down. Later this month he is throwing a lavish birthday party, with entertainment provided by The Eagles—even though his decision to buy Tribune must now feel a bit like having checked in at the Hotel California.

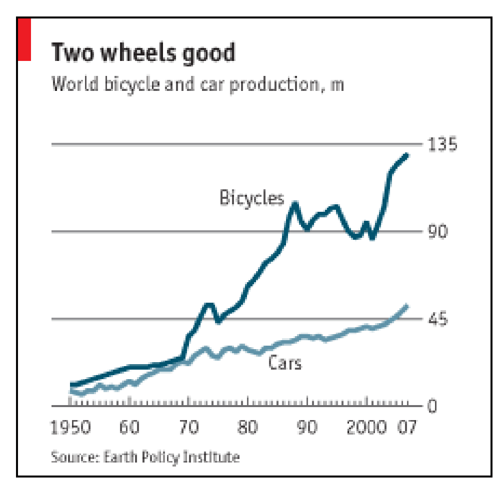
 **BUSINESS**

Giant Manufacturing

On your bike

Sep 18th 2008 | TAICHUNG, TAIWAN
From The Economist print edition

Obesity and high oil prices are good news for the world's biggest bikemaker



THESE are tough times for carmakers, many of which are labouring under high oil prices, slowing demand and financial weakness. For makers of human-powered, two-wheeled vehicles, by contrast, business is booming. Giant Manufacturing, the world's largest bicycle-maker, sold a record 460,000 units last month and is heading for its best year ever. Such is the demand for bikes that shortages were reported in New York earlier this year. In Taiwan, Giant's home market, supply is tighter still: for many models, buyers put down deposits months before their bikes come off the assembly line.

After a slow 2006, sales took off last year in Europe and America as fuel prices shot up. Suddenly a bicycle seems like the remedy for many modern ills, from petrol prices to pollution and obesity. Each market has its own idiosyncrasies. Europeans mainly use bikes for commuting, but have the odd habit of ignoring models made explicitly for that purpose in favour of sleeker, faster models which are then expensively modified. Americans prefer off-road BMX trail bikes. Taiwanese demand is led by racing-style bikes used for exercise.

Giant, as the largest producer, makes everything for every market. Its share price has held up fairly well despite stockmarket turmoil and dramatically higher costs for raw materials, notably aluminium. Strong demand and a desire for better bikes have allowed bikemakers to pass higher material costs on to buyers. Since 2004 wholesale prices of bikes have gone up by 23% in Europe, 45% in America and almost 50% in Asia, even as thousands of low-cost factories in China, including some run by Giant, churn out boatloads of cheap bikes.

Giant began in 1972, taking advantage of low-cost Taiwanese labour to make bicycles for foreign firms as well as domestic buyers. A critical early order came from Schwinn, the dominant American brand of the time, which wanted to reduce its dependence on a factory in Chicago that was beset by poor labour relations and low productivity. After contracting out to Giant proved successful, Schwinn shifted its orders to a factory in southern China. But quality was poor, deliveries were late and Schwinn slid into bankruptcy. (It is now owned by Dorel Industries of Canada.)

Meanwhile, having started out as a low-cost manufacturer, Giant was moving upmarket. Even its cheapest bikes, which are sold in China, are relatively expensive (at around $100), yet Giant has the largest market share, at around 7%, according to Deutsche Bank. Globally, Giant is one of a handful of big companies that can make frames and forks (the most important components of a bicycle) out of sophisticated alloys and carbon fibre. Components from other manufacturers are then added to the frame. The resulting bikes are sold under Giant's own name, or under contract to big customers in Europe and America.

Because frame- and component-makers are happy to sell to potential competitors, there are in effect no barriers to entry to the bike business—all that is needed is a brand name. As a result, competition is brutal. Capturing customers at volume, and at ever-higher prices, requires an unending series of improvements. Giant will soon begin distributing a new frame with built-in lightweight shock-absorbers, which should appeal to riders on potholed streets and off-road trails. Details of the design remain a secret, because good ideas are commonly copied within a year. By then, Giant must come up with a further innovation. It is the only way to survive.

Japan’s luxury-goods market

Losing its shine

Sep 18th 2008 | TOKYO
From The Economist print edition

Why sales of luxury goods are slowing

WHEN Louis Vuitton, part of LVMH, the world’s biggest luxury-goods firm, opened a giant shop in Tokyo’s Omotesando district in 2002, hundreds of people queued outside. The first day’s takings surpassed $1m. Rather than symbolising Japan’s apparently insatiable desire for luxury goods, however, this may have marked the start of its decline. Long the world’s most lucrative market for such products, Japan’s star is fading. Having been stagnant for half a decade, sales have fallen dramatically this year for many brands. Hermès, Gucci, Tiffany, Chanel and Cartier have all felt the pinch. LVMH’s sales in Japan slid by 6% in the first six months. This year may be the first since the company’s arrival in Japan in 1978 in which its sales in the country go down.

Surprisingly, the luxury-goods business is having a strong year, largely thanks to demand in China, the Gulf and other emerging economies. (Indeed, things have been so good that perfume-makers face a new product-liability problem in Russia, where oligarchs’ girlfriends buy dozens of bottles in order to bathe in a fragrance, unaware that this can be deadly.) Japan, which experienced similar excesses in the 1980s, still accounts for around a quarter of global luxury-goods sales. The Japanese market for imported luxury products—clothes, shoes, handbags and accessories—was worth ¥1.2 trillion ($10.2 billion) in 2007, a drop of 39% since 1996. As sales have fallen, the big labels’ market shares have increased: Louis Vuitton’s sales have almost tripled over the period, to ¥165 billion.

The malaise has both short- and long-term causes. The weak economy, and the steady appreciation of the euro against the yen in recent years, has dampened demand. The luxury-goods industry is often said to be immune to such ups and downs, since the mega-rich go on spending no matter what. That may be true in countries with high income-inequality. But in Japan many buyers of luxury goods have been ordinary middle-class office workers, some of whom save up for years.

There is also a longer-term trend at work. Japan overflows with “parasite singles”—adults living with their parents—who are flush with money that would otherwise go on rent. As fewer women marry and have children, they have more cash to spend. All of this fuelled Japan’s strong demand for luxury goods. But as the population ages, there are fewer young, wealthy and fashion-mad customers.

Buyers’ tastes have also become more sophisticated. The days of simply slapping on a logo and charging a ridiculous price are gone, says Fiona Wilson, the Asia editor of *Monocle*, a style magazine. Instead, there is more interest in craftsmanship and value for money. Coach, a maker of more affordable handbags and accessories, reported sales growth of 19% in Japan last year. Its peers’ sales were flat at best.

To support their sales, Louis Vuitton and Gucci have launched less expensive collections made with cheaper materials. Big brands are also opening stores in smaller cities, where the lure of the logo still works. The big question is whether Japan is an isolated example, or signals a broader shift in demand. Perhaps it is a bit of both. If customers in other developed countries are no longer so dazzled by labels, the big brands will come to rely even more on fast-growing emerging economies, where the new rich go gaga over glam at any price.

Biofuels in India

Power plants

Sep 18th 2008 | DHANORA, CHHATTISGARH
From The Economist print edition

The slow ripening of India's biofuel industry

Reuters



Seeds of hope

OUTSIDE his village in the Indian state of Chhattisgarh, Sudarshan Dhrube inspects a field of jatropha, planted in rust-red soils, heavy with iron. His village is growing the shrub under the watchful eye of D1-BP Fuel Crops, a joint venture between D1 Oils, a British biofuels firm, and BP, an energy giant. D1-BP has promised to pay 6.50 rupees (14 cents) for every kilogram of the black seeds found inside the shrub's fruit. Crushed, these seeds yield a viscous oil that burns with a clear, clean flame. The oil can run a generator or a pump. Or it can be refined into biodiesel that can fuel tractors, trucks or trains.

Jatropha contains a toxic protein similar to ricin. It was traditionally consigned to hedgerows, protecting more valuable, edible crops from peckish goats. The Shambaa tribesmen of Tanzania forced suspects to eat it. If they vomited, they were innocent. If they died, they weren't.

Now the world is being asked to digest big claims for this poisonous plant. It will help meet the world's demand for fuel, without crowding out the world's supply of food. It will regenerate dry and denuded soils, and create jobs for impoverished farmers. India accounts for about two-thirds of the world's jatropha plantations, according to New Energy Finance, a research firm, and a hefty share of the enthusiasm. India's previous president planted it in his garden and Chhattisgarh's chief minister runs his official car on its oil.

On September 12th the government followed up these gestures with a new national biofuel policy. By 2017 it aims to meet 20% of India's diesel demand with fuel derived from plants rather than fossils. That will mean setting aside 14m hectares of land, according to the National Council of Applied Economic Research, a Delhi think-tank. By one count, jatropha now covers less than 500,000 hectares.

Biodiesel is not the only kind of biofuel: India also makes bioethanol from molasses left over from refining sugarcane. And jatropha oil is not the only source of biodiesel. The shrub has a more elegant rival in *pongamia pinnata*, or Indian birch, a silvery tree revered for its shady canopy and medicinal properties. Its crescent-shaped pods also contain seeds which can yield about 30% of their weight in oil, according to Roshini International Bio Energy, a firm based in Hyderabad. It has joined hands with the Andhra Pradesh government to plant the trees in three of Andhra Pradesh's 23 districts. It is also venturing into neighbouring states and to Indonesia, Sri Lanka and Uganda. The goal, says Anil Reddy, Roshini's founder, is "to plant 1 billion trees on this planet", covering an area half the size of Denmark.

India's enthusiasm for biofuel may seem odd only months after the country's finance minister described conversion of food crops into biofuel as "a crime against humanity." But D1-BP and Roshini point out that their favoured crops need not compete with food crops for land or water. Both are hardy plants that can grow on dry, stony soil. S.K. Kothari, Roshini's technical director, says 150 acres of *pongamia* requires

only as much water as a single acre of traditional crops.

But sceptics say these crops take too long to bear fruit and their yield is unreliable. Jatropha reaches full maturity in its fourth or fifth year; *pongamia* in its ninth. It is not easy to convince small farmers to devote care and attention to an untried crop which takes so long to provide a return. But without such care, especially in the crop's infancy, the yield will disappoint, confirming the farmers' doubts.

The answer lies in agronomy and sociology. Roshini has painstakingly accumulated a "gene bank" of high-yielding mother trees. Stems from these fecund plants can be grafted onto 200-300 saplings, which will then inherit the mother tree's desirable properties, fruiting earlier and more reliably.

Breeding confidence and commitment in the farmers is, however, just as important. They require a lot of "handholding", says Samiran Das of D1-BP. His firm has tried to generate a "community feeling" around its projects. For example, it has hired Dukhiya Yadav, the head of a village self-help group, to collect seeds from the farmers and sort the bad from the good, for half a rupee per kilogram. That gives her a stake in the farmers' success.

Mr Dhrube, inspecting his jatropha field in Chhattisgarh, confesses some doubts about whether he will see a return this year. The leaves of the plants are drooping mournfully in the 42ºC heat. But an adviser from D1-BP assures him they will perk up when the sun goes down.

Face value

The quiet Brazilian

Sep 18th 2008
From The Economist print edition

Daniel Dantas, a brilliant and controversial banker, is waiting to see if he will go to jail

AE



IT IS three o'clock in the afternoon, and Daniel Dantas has just discovered that $300m of his bank's money has been frozen by the courts. The morning's papers were filled with stories about Mr Dantas, government spies, wiretapping and money-laundering. His São Paulo offices, which have the usual accoutrements of investment-bank meeting rooms—Venetian blinds revealing a commanding view of the city, paper and pencils branded with the bank's name—feel like a fort under siege. Mr Dantas enters the room, places his various mobile phones on a table and removes their batteries. At least one of them has been bugged by Brazil's spy agency, he says, turning it into a listening device.

Mr Dantas is the most controversial businessman in Brazil. The press has tried to connect his name with every big scandal of the past ten years in the wide grey area where business and government meet. But none of the accusations has ever been proven. In July Mr Dantas was taken into custody for a day but was released without charge. Mr Dantas is often portrayed as a kind of dark genius of Brazilian finance: Darth Vader with spreadsheets. He has, he notes in a tone of incredulity that perhaps contains a little pride, appeared on the cover of one of the country's business magazines more often than George Bush.

Teetotal, vegetarian and frugal, Mr Dantas seems an unlikely target for such opprobrium. Even though he has amassed a fortune estimated at $1 billion, his apartment in Rio de Janeiro is said to be decorated with posters from art galleries, rather than original works. He does not own a beachfront house, a helicopter or a fast car. In this at least, he resembles Warren Buffett, one of his heroes. Mr Dantas works every day from early in the morning until late at night and his personal life appears to be somewhere between uneventful and non-existent.

Before his legal troubles began, Mr Dantas was known primarily for his brains. He grew up in Bahia, in the north-east, in a family patronised by Antonio Carlos de Magalhães, a political boss who controlled the state at the time. After an undergraduate degree in engineering, he went to Rio to study for a PhD in economics. Mr Dantas was a dedicated student (he even delayed his wedding to attend an academic conference) who went on to do postgraduate work in economics at the Massachusetts Institute of Technology, all the while maintaining commercial interests in Brazil. Having completed his studies, Mr Dantas spent profitable spells at a couple of banks. One of the funds he managed returned 156% for the year, making him the world's best-performing asset manager for the year in 1993. (George Soros's Quantum Emerging fund only managed fourth place, with a return of 92%.) In 1994 Mr Dantas founded his own bank, Opportunity. Even during the bank's run-ins with the courts, its fund-management arm, run by Dório Ferman, has continued to perform amazingly well.

The roots of Mr Dantas's current problems lie in 1998, when Brazil's state-owned telecoms industry was privatised. Among the bidders for concessions was a consortium made up of Telecom Italia, Citibank and some large pension funds co-ordinated by Mr Dantas. Mr Dantas pulled off two coups: he persuaded Citibank to invest alongside Opportunity, and two state-run pension funds to give him control of their stakes in the privatised entity, Brasil Telecom. This gave him control of a big company, even though Opportunity owned only 1% of its equity.

Then the trouble began. Opportunity and Telecom Italia fell out, and a power struggle ensued in which Citibank backed Mr Dantas. The dispute rumbled on until 2004, when it emerged that Brasil Telecom had hired Kroll, an American security firm. Reports in the Brazilian press, flatly denied by Kroll, claimed that the company had tried to spy on politicians, journalists and businessmen. Mr Dantas says these reports are nonsense and that Kroll was only hired to track down some money that had gone missing. In the same year, it emerged that Brasil Telecom had made payments to a company owned by the son of President Luiz Inácio Lula da Silva. Telecom Italia eventually sold its stake to Citigroup and the pension funds last year. By then Mr Dantas had fallen out with them, too. In 2005 Citibank fired Opportunity, claiming that Mr Dantas had acted against its interests. It also brought a lawsuit against Opportunity in New York.

Fighting his corner

Mr Dantas says this was a betrayal, and he found it hard to take. He explains that he and his lawyers in New York had to develop a code when discussing the suit, because their opponents often seemed to know their next move. (The suit was resolved in April this year, but details of the settlement were not made public.) Ever since the telecoms privatisations, he says, people in the government have gone after him. At first, he says, this was because he was assumed to have political ties to opposition figures in Bahia, and was therefore deemed to be an unsuitable owner of previously state-owned utilities.

A few years after Lula's election in 2002, Mr Dantas claims, pressure on him increased. This may have had something to do with the downfall of José Dirceu, Lula's chief of staff, who is said to have been Mr Dantas's point of contact in the administration. At the root of it all, Mr Dantas alleges, is the need for politicians to siphon off money for election campaigns, and those who refuse to co-operate become targets. The latest accusations made by the federal police against Mr Dantas—which centre on the laundering of public money and the offering of bribes to be excluded from an investigation—are, he says, just a continuation of this campaign. This led to the freezing of funds on September 11th.

If he is right, then the Brazilian press is wrong. But innocent or guilty, it seems increasingly likely that Mr Dantas will avoid conviction, not least because of the irregular way in which the police have conducted their operation. If this happens, it will only add to his reputation for having close shaves with the law.

Economist.com FINANCE & ECONOMICS

The financial crisis

Wall Street's bad dream

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From The Economist print edition

In a special nine-page report, we look at how the global financial system has fallen into the grip of panic

Illustration by S. Kambayashi



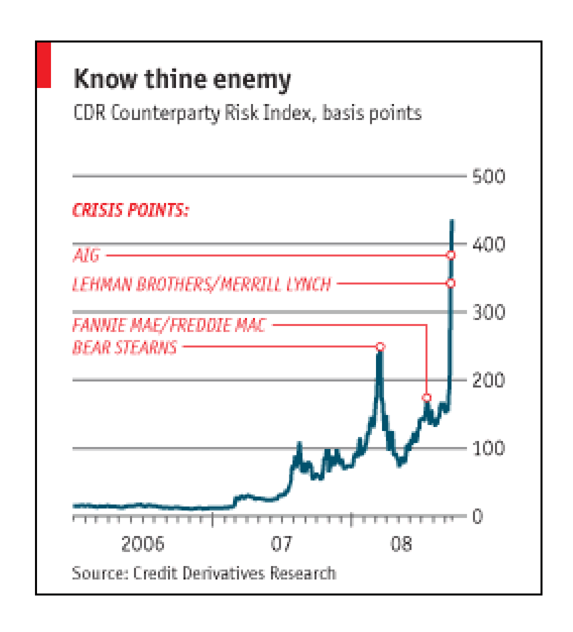
“THINGS are frankly getting out of hand and ridiculous rumours are being repeated, some of which if I wrote down today and re-read tomorrow, I’d probably think I was dreaming.” So said an exasperated Colm Kelleher, Morgan Stanley’s finance chief, during a hastily arranged conference call on September 16th.

The carnage of the past fortnight may have an unreal air to it, but the damage is all too tangible—whether the seizure of Fannie Mae and Freddie Mac by their regulator, the record-breaking bankruptcy of Lehman Brothers (and the sale of its capital-markets arm to Barclays), Merrill Lynch’s shotgun marriage to Bank of America or, most shocking of all, the government takeover of a desperately illiquid American International Group (AIG).

The rescue of the giant insurer was justified on the grounds that letting it fail would have been catastrophic for financial markets. As it happened, even AIG’s rescue did not stop the bloodletting. On September 17th shares in Morgan Stanley and the other remaining big investment bank, Goldman Sachs, took a hammering. Even though both had posted better-than-expected results a day earlier, confidence ebbed in their stand-alone model, with its reliance on flighty wholesale funding. An index that reflects the risk of failure among large Wall Street dealers has climbed far above its previous high, during Bear Stearns’s collapse in March (see chart).

It is a measure of the scale of the crisis that, by the evening of September 17th, all eyes were on Morgan Stanley, and no longer on AIG, which only 24 hours before had thrust Lehman out of the limelight. After its share price slumped by 24% that day, and fearing a total evaporation of confidence, Morgan attempted to sell itself. Its boss, John Mack, reportedly held talks with several possible partners, including Wachovia, a commercial bank, and Citic of China. As contagion spread far and wide, on September 18th central banks launched a co-ordinated attempt to pump $180 billion of short-term liquidity into the markets. HBOS, Britain’s biggest mortgage lender, also sold itself to Lloyds TSB, one of the grandfathers of British banking, for £12.2 billion ($21.9 billion) after its share price plunged. The government was so anxious to broker a deal that it was expected to waive a competition inquiry.

Financial panics have been around as long as there have been organised economies. There are common themes. The cause of today's crunch—the buying of property at inflated prices in the hope that some greater fool will take it off your hands—has featured many times in the past. And the withholding of funds by institutional investors is merely the modern version of an old-fashioned bank run.



The same, and yet different

But each has its own characteristics, which makes it difficult for students of past crises to apply lessons. Ben Bernanke, the chairman of the Federal Reserve, may be a scholar of the Depression, but the vastness and complexity of the financial system, and the speed with which panic is spreading, create a daunting task.

Though they are putting on a brave face, officials could be forgiven for feeling at a loss as one great name buckles after another and investors flee any financial asset with the merest whiff of risk. Even the politicians have been stunned into inactivity. Congress probably will not pass new financial legislation this year, admitted Harry Reid, the Senate majority leader, because "no one knows what to do."

At times, the responses appear alarmingly piecemeal. Amid a fresh clamour against short-sellers—Morgan Stanley's Mr Mack accused them of trying to wrestle his stock to the ground—the Securities and Exchange Commission, America's main markets regulator, brought back curbs on "naked", or potentially abusive, shorts. It also rushed out a proposal forcing large investors, including hedge funds, to disclose their short positions. Calstrs, America's second-largest pension fund, said it would stop lending shares to "piranhas".

As in August 2007, when the crisis began in earnest, money markets were this week seizing up. The price at which banks lend each other short-term funds surged, leaving the spread over government bonds at a 21-year high. A scramble for safety pushed the yield on three-month Treasury bills to its lowest since daily records began in 1954—the year President Eisenhower introduced the world to domino theory.

Aptly enough, the crisis is spreading from one region to the next. Asian and European stockmarkets suffered steep falls. Japan was fretting that Lehman's potential default on almost $2 billion of yen-denominated bonds would send a chill through the "samurai" market. Russia suspended share-trading and propped up its three largest banks with a handy $44 billion, as emerging markets lost their allure.

Another weak spot is the $62 trillion market for credit-default swaps (CDSs), which has given regulators nightmares since the loss of Bear Stearns. It did not fall apart after the demise of Lehman, another big dealer. But it remains fragile; or, as one banker puts it, in a state of "orderly chaos".

CDS trading volumes reached unprecedented levels this week, and spreads widened dramatically, as hedge funds and dealers tried to unwind their positions. But as margin requirements rise, few participants are taking on much risk, according to Tim Backshall of Credit Derivatives Research. The turmoil will embolden those calling for the opaque, over-the-counter market to move onto exchanges. Nerves on Wall Street would be jangling less if a central clearinghouse, planned for later this year, was already up and running.

The CDS market may have figured in the government's calculations of whether to save AIG, given that its collapse would have forced banks to write down the value of their contracts with the insurer, further straining their capital ratios. But officials also had an eye on Main Street. Some of AIG's largest insurance businesses serve consumers; its failure would have shaken their confidence. As it was, thousands lined up outside its offices in Asia, with some looking to withdraw their business.

Consumers are already twitchy in America, where bank failures are rising and the nation's deposit-insurance fund faces a potential shortfall. The failure of Washington Mutual (WaMu), a troubled thrift, could at the worst wipe out as much as half of what remains in the fund, reckons Dick Bove of Ladenburg Thalmann, a boutique investment bank. WaMu was said this week to be seeking a buyer.

No less worrying are the cracks appearing in money-market funds. Seen by small investors as utterly safe, these have seen their assets swell to more than $3.5 trillion in the crisis. But this week Reserve Primary

became the first money fund in 14 years to “break the buck”—that is, to expose investors to losses through a reduction of its net asset value to under $1—after writing off almost $800m in debt issued by Lehman.

Any lasting loss of confidence in money funds would be hugely damaging. They are one of the last bastions for the ultra-cautious. And they are big buyers of short-term corporate debt. If they were to pull back, banks and large corporations would find funds even harder to come by.

Coming to a bank near you

At some point the Panic of 2008 will subside, but there are several reasons to expect further strain. Banks and households have started to cut their borrowing, which reached epic proportions in the housing boom, but they still have a long way to go. By the time they are finished, the pool of credit available across the markets will be smaller by several trillion dollars, reckons Daniel Arbess of Perella Weinberg Partners, an investment and advisory firm. A recent IMF study argued that the pain of deleveraging will be felt more keenly in Anglo-Saxon markets, because highly leveraged investment banks exacerbate credit bubbles, and are then forced to cut their borrowing more sharply in a downturn.

Furthermore, it is far from clear, even now, that banks are marking their illiquid assets conservatively enough. Disclosures accompanying third-quarter results, for instance, showed a lot of disparity in the valuation of Alt-A mortgages (though definitions of what constitutes Alt-A can vary). “Level 3” assets, those that are hardest to value, will remain under pressure until housing stabilises—and that may be some time yet. Jan Hatzius of Goldman Sachs expects house prices in America to fall by another 10%. Builders broke ground on fewer houses than forecast in August, suggesting the housing recession will continue to drag down growth.

The pain is only now beginning in other lending. “We may be moving from the mark-to-market phase to the more traditional phase of credit losses,” says a banker. This next stage will be less spectacular, thanks to accrual accounting, in which loan losses are realised gradually and offset by reserves. But the numbers could be just as big. Some analysts see a wave of corporate defaults coming. Moody’s, a rating agency, expects the junk-bond default rate, now 2.7%, will rise to 7.4% a year from now. Like many nightmares, this one feels as if it will never end.

Saving Wall Street

The last resort

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From The Economist print edition

The American government's bail-outs are less arbitrary than they appear

SIX months after the American government supported the sale of Bear Stearns to JPMorgan Chase, leading to the end of one of Wall Street's "Big Five", it tried to make it clear last weekend that there would be no further bail-outs, and let Lehman Brothers fail. Two days later, that line in the sand had all but blown away.

The Treasury's decision on September 16th to take over American International Group (AIG), one of the world's biggest insurers, in exchange for an $85 billion credit line from the Federal Reserve, was momentous. More so than allowing Lehman Brothers, which was even bigger than Bear Stearns, to go bust the day before; more so, even, than the takeover of Fannie Mae and Freddie Mac, the big mortgage agencies, just over a week before. With AIG, the stakes were higher for both the financial system and the authorities' credibility.

Fannie and Freddie always had implicit federal backing, so when they tottered, the federal government had little choice but to make that support explicit. Bear Stearns was a regulated investment bank whose demise was so sudden that its collapse could have caused a maelstrom.

AIG is an insurer, not a bank, and as such had neither federal backing nor much federal oversight. Yet it quietly built itself into a juggernaut in the global financial system by using derivatives to insure hundreds of billions of dollars of corporate loans, mortgages and other debt. Holders of these assets ranged from the world's biggest banks to retired people's money-market funds. Allowing AIG to fail could have panicked small investors, forced banks to take steep write-downs, and introduced a terrifying new phase to the financial crisis.

To some, the institution-by-institution approach to bail-outs seems haphazard. "Mr Secretary...you're picking and choosing. You have to have a set policy," Richard Shelby, the leading Republican on the Senate banking panel, complained to Hank Paulson, the treasury secretary.

In fact, back in July Mr Paulson had argued in favour of a formal mechanism to take over and wind down non-banks, such as investment banks and insurers, in an orderly way, much as already exists for retail banks. But Congress was only prepared to consider that as part of a bigger regulatory overhaul under the next president. That forced Mr Paulson, Ben Bernanke, the Fed's chairman, and Timothy Geithner, the president of the New York Fed (the three are virtually joined at the hip) to pursue rescues ad hoc. Yet a certain logic has governed their actions.

It is possible to detect a pattern of sorts emerging in Mr Paulson's interventions. First, establish if a firm is so large or so entangled within the financial system that its unexpected failure could be catastrophic. If the answer is "no", as the authorities concluded it was in Lehman's case, encourage a private sale but commit no public money. If the answer is "yes", as with Bear, Fannie and Freddie, and AIG, then make sure that taxpayers get first claim on the assets, common and preferred shareholders pay a steep price, and management is replaced. Mr Paulson argues that the approach combines pragmatism with an intense focus on moral hazard, or letting people pay for failure. "I don't believe in raw capitalism without regulation. There's got to be a balance between market discipline, allowing people to take losses, and protecting the system," he says.

Assuming the markets eventually right themselves, the bail-outs may hasten healthy consolidation. American economic growth has been heavily dependent on borrowing and leverage for the last decade. AIG had used its unregulated status to supply cheap credit protection to regulated entities. But that business thrived in a period of easy credit and low defaults. When those conditions ended, it produced enough losses to nearly bankrupt AIG.

Lehman's bankruptcy and AIG's failure suggest Wall Street has too much leverage and too much capital

devoted to products of questionable economic utility. The bail-outs will facilitate a deleveraging. The Fed expects AIG to repay its loan by selling off its healthy businesses, while winding down its derivatives book. Mr Paulson wants Fannie and Freddie to reduce much of their mortgage portfolios.

"The necessary shrinking of the financial system is taking place in real time," says Kenneth Rogoff of Harvard University. It could go too far. If the cycle of falling asset prices, insolvency and credit constriction is excessive, the government may have to step in and buy up bad assets en masse, as has often occurred in other financial meltdowns (see article).

Even without such drastic action, the economy and the financial system are becoming dependent on the taxpayer. Bank of America was in a position to buy Merrill Lynch in part because the Federal Deposit Insurance Corporation, which guarantees deposits, insulates a large share of the bank's funding from crises of confidence.

With federal backing comes federal oversight. Even the most free-market policymakers will be reluctant ever to see another company get as large and interconnected as AIG without tougher regulation. Just as the Fed insisted on more oversight of investment banks when it agreed to lend to them in March, it will now have the authority to inspect the books of AIG any time it chooses.

This poses risks to the Fed. Thrust to the fore during the crisis, its role in the financial system has expanded. It has so far balanced these responsibilities with its attention to inflation. On September 16th it defied market hopes for lower interest rates and kept its short-term target at 2%. It judged that for now, expanding its loans to banks and securities dealers, and broadening the collateral it accepts from banks, addresses the crisis better than looser monetary policy would, though it may yet decide further rate cuts are necessary.

Still, the Fed has lent so heavily to the most beleaguered financial firms that it is running out of bonds. The government has promised to help with a special issuance of Treasury bills which, through the machinations of reserve management, will result in a larger Fed balance sheet but no impact on interest rates.

The Fed needs to be sure it does not become a crutch for insolvent financial firms, distorting credit allocation and risk taking. For the time being, though, that concern is far less important to it than keeping the financial system intact.

Investment banking

Is there a future?

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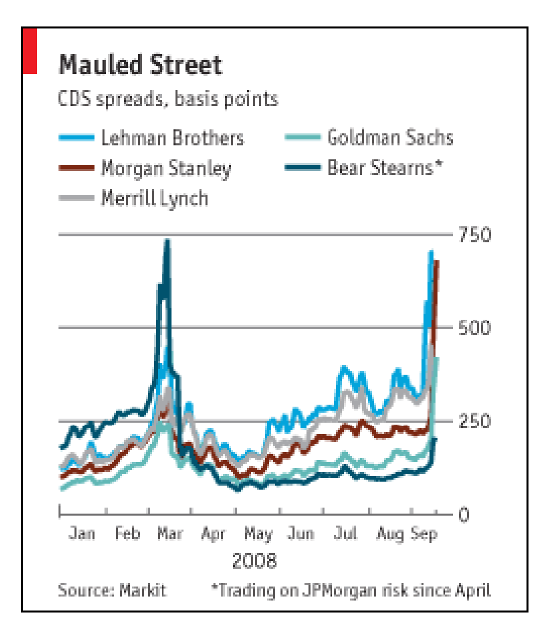
The loneliness of the independent Wall Street bank

EPA



IN THE early years of this decade, when banks did quaint things like making money, the mantra on Wall Street was: “Be more like Goldman Sachs”. Bank bosses peered enviously at the profits and risk-taking prowess of the venerable investment bank. No longer. “Be less like Goldman Sachs” is the imperative today.

Of the five independent investment banks open for business at the start of the year, only Goldman and Morgan Stanley remain. Doubts about the sustainability of the model are rife. In earnings conference calls on September 16th, the chief financial officers of both firms had to bat away analysts’ questions about their ability to survive on their own. Spreads on their credit-default swaps, which protect against the risk of default, soared as investors digested the implications of Lehman Brothers’ demise (see chart).



Universal banks, which marry investment banking and deposit-taking, are in the ascendant. Bear Stearns and Merrill Lynch found shelter in the arms of two big universal banks, JPMorgan Chase and Bank of America. Barclays, a British universal bank, is picking at the carrion of Lehman Brothers. The mood at Citigroup, seen until now as one of the biggest losers from the crisis, is suddenly bullish: insiders talk up the stability of its earnings and the advantages of deposit funding.

Regulatory antipathy to universal banks has also eased. Although the 1933 Glass-Steagall act, which separated investment banks and commercial banks, was repealed in 1999, the universal model is still viewed with suspicion in America. Among measures announced on September 14th, the Federal Reserve temporarily suspended rules restricting the amount of money that banks can lend to their investment-banking affiliates. Many are sceptical that this rule makes much practical difference. Even if the investment-banking arms of universal banks nominally have to raise money separately, their parents’ ratings still make their funding cheaper. By the same token, if they get into trouble, the effects ripple through the entire balance-sheet. Even so the suspension, and the dramatic reshaping of Wall Street, represents the final repeal of Glass-Steagall.

Can Goldman and Morgan Stanley survive as independents? In normal times, the question would seem ludicrous. Both banks had profitable third quarters, with Morgan Stanley beating expectations

comfortably. Rivals' disappearance should allow them to grab new business and has already helped to increase pricing power: Morgan Stanley hauled in record revenues in its prime-brokerage business. Both have reduced their most troubling exposures; both can call on decent amounts of capital and strong pools of liquidity. And both can marshal strong arguments that they are better managed than their erstwhile peers.

The problem, of course, is that these are not normal times. Although the firms condemn the rumour-mongering, stories that Morgan Stanley was looking for a partner continued to swirl. As *The Economist* went to press, Wachovia, an American bank, and Citic of China were among the names in the frame.

Three doubts hang over the independent model. The first concerns the risk of insolvency. Investment banks have higher leverage than other banks (in America at least), which worsens the impact of falling asset values. They do not have the safety-valve of banking books, where souring assets can escape the rigours of mark-to-market accounting. And they lack the stable earnings streams of commercial and retail banking. In other words, they have less room for error. Goldman's reputation for risk management is excellent, Morgan Stanley's a bit patchier. But asking investors to take valuations and hedging processes on trust is getting harder by the day.

The second, related doubt concerns their funding profile. As a group, the pure-play investment banks have relied heavily on short-term funding, particularly repo transactions in which counterparties take collateral as security against the cash they lend. Both survivors say they are nowhere near as exposed to the risk of a sudden dearth of liquidity as Bear Stearns was. They could also argue that retail deposits can be as flighty as the wholesale markets: just ask Northern Rock and IndyMac, both of which suffered rapid withdrawals. Even so, a further shift towards longer-term unsecured financing will be the price of survival for Morgan Stanley in particular.

That would increase costs, which in turn raises the third doubt, profitability. As well as dearer funding and lower leverage, the investment banks face the prospect of weakened demand for their services. As and when the market for structured finance revives, it will be smaller and less rewarding than before. Demand for many services will not go away, but in a world of scarcer credit, universal banks will be tempted to use their lending capacity to win juicier investment-banking business from companies. "Don't give me the bone," says one European bank boss. "Leave some meat on it."

By these lights, universal banks appear to offer clear advantages to both shareholders and regulators. Yet some of those advantages are illusory. For regulators, larger, diversified institutions may be more stable than investment banks but they pose an even greater systemic risk. "The universal bank is the regulatory equivalent of the super-senior mortgage-backed bond," says one analyst. "The risks may look lower but they do not go away." And deposit funding is cheaper than wholesale funding in part because those deposits are insured. Measures to protect customers may end up allowing banks to take on risks that endanger customers.

For shareholders, too, the universal bank may offer false comfort. A model that looks appealing in part because assets are not valued at market prices ought to ring alarm bells. Sprawling conglomerates are just as hard to manage as turbo-charged investment banks. And shareholders at UBS and Citi will derive little comfort from the notion that the model has been proven because their institutions are still standing. If the independent investment banks survive, they will clearly need to change. But they are not the only ones.

Economist.com FINANCE & ECONOMICS

Buttonwood

Looking for the bright side

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From The Economist print edition

Are there any signs that this could be a buying opportunity?

Illustration by S. Kambayashi

WHEN Winston Churchill lost the 1945 election, his wife remarked that the defeat might be a blessing in disguise. "At the moment", replied the great man, "it seems quite effectively disguised."

It is possible, when investors view recent events in retrospect, they will see them as a turning point for markets. But if there are immediately bullish implications, they seem to be quite effectively disguised. The American authorities sacrificed Lehman Brothers "to encourage the others", only to find the others were simply encouraged to deny funding to weak-looking institutions.

Risk aversion reached extremes this week as the money markets froze. Overnight dollar rates doubled in the interbank market while the rate paid by the American government for three-month money fell to its lowest in more than 50 years. In addition, the caning the authorities gave to shareholders in Fannie Mae, Freddie Mac and AIG, however hard to argue with, will make it tough for financial institutions to raise new equity. Wall Street did not even bother to rally after the AIG deal as it had after previous government interventions.

Bad news seems to be coming from all sides, leaving Hank Paulson, America's treasury secretary, increasingly resembling a one-armed wallpaper hanger as he valiantly seeks to cope with the mess. Another problem emerged this week; a $65 billion money-market fund, Reserve Primary, suspended redemptions and warned that it would "break the buck", ie, repay investors at less than face value. That could cause a flight out of other money-market funds. Meanwhile, credit spreads over risk-free rates have widened sharply and emerging markets have taken a hammering.

The "great deleveraging" is working its way through the markets, as institutions, unable to roll over their debts, are forced to sell assets. The resulting fall in prices raises doubts about the solvency of other businesses, giving the spiral another downward lurch.

So what good news can be found in the midst of all this gloom? The first, curiously enough, is that sentiment is very depressed. The latest poll of global fund managers by Merrill Lynch found that risk appetite is at its lowest level in over a decade. Such extremes are normally a bullish sign.

The second is that the government is not the only buyer. After Merrill Lynch's sale to Bank of America, HBOS, a British mortgage lender, has also sought refuge within a bank, Lloyds TSB. That suggests executives see value in today's prices. Whether this is out of shrewd bargain-hunting, state arm-twisting or over-ambitious empire-building remains to be seen.

The third is that the inflation threat has receded, thanks to the sharp fall in commodity prices. Eventually, that will allow central banks to cut interest rates. In addition, it will relieve the pressure on consumer demand and corporate profit margins.

The fourth factor is that central banks are also willing to undertake quite extraordinary market-support measures, including the Fed's decision to accept equities as collateral against lending at its discount window. That would have been unthinkable 18 months ago.

The fifth issue is that valuations in equity markets have improved substantially. In Britain on September 17th, the yield on the FTSE All-Share index was higher than the yield on ten-year gilts. This has happened only once before since the late 1950s—in March 2003, which proved to be the start of a long rally.

However, it would be a brave investor that acted on those bullish signals today. Those who believed that the Bear Stearns collapse in March marked a turning point in the credit crunch were disappointed. The Vix, or volatility index, a measure of market preparedness for shocks, has been lower than in past peaks—though it shot up on September 17th.

While the money markets are frozen, other financial institutions may get into trouble. Buyers will be tempted to wait until asset prices fall further, a strategy that worked for Barclays, which was able to choose the slice of Lehman Brothers it desired. And the economy will surely have been harmed by this week's turmoil; consumer sentiment will have been hit and banks will inevitably prove even more cautious about their lending. A recession seems more likely than it did at the start of the month.

Perhaps there will be no climactic sell-off to signal the end of the bear market. Instead share prices may simply bounce around in a choppy range near today's values. It is quite plausible that those who buy shares today will look smart in five years' time. It is much less certain they will look smart six months from now.

Economist.com FINANCE & ECONOMICS

AIG's rescue

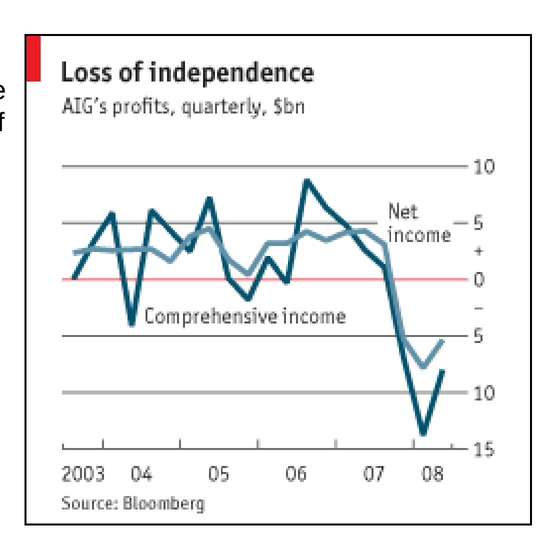
Size matters

Sep 18th 2008
From The Economist print edition

Why one of the world's biggest insurers needed a government rescue

EVEN by the recent standards of Wall Street bailouts, that of American International Group is colossal. At its peak the insurance firm was the world's largest with a market value of $239 billion. Its assets are bigger than those of either Lehman Brothers or Fannie Mae. Yet size alone does not explain the rescue. Nor do the images of customers queuing to cancel their policies as far away as Singapore. AIG posed a systemic risk because of its investment bank, tucked away behind the dull business of writing insurance contracts, which has lost it both a fortune—and now its independence (see chart).

At one stage, this unit contributed over a quarter of profits. It has played the role of schmuck in one of finance's most dangerous games by writing credit-default swaps (CDSs), a type of guarantee against default, with a giant notional exposure of $441 billion as of June. Of this, $58 billion is exposed to subprime securities which have already generated huge mark-to-market losses. For regulators, the real horror story may be the $307 billion of contracts written on instruments owned by banks in America and Europe and designed to guarantee the banks' asset quality, thereby helping their regulatory capital levels.



How much pain taxpayers will ultimately bear is an open question. The official line is that AIG only suffered a liquidity crisis. As subprime losses mounted, it had to put up more collateral with its counterparties, in turn prompting credit-rating downgrades, which in turn triggered more margin calls. It is probable that operating cashflow was drying up too as big risk-sensitive commercial customers stopped doing business with the insurer. On September 16th the Federal Reserve extended a two-year, $85 billion credit facility at a penal rate. The government will get a 79.9% stake in the company in return. The idea is that this buys time for AIG to improve its liquidity in an orderly way. The bail-out's structure should also avoid a technical bankruptcy, which could force the unwinding of many of those CDS contracts.

Yet might the government be taking over a company that is insolvent as well as illiquid? Extrapolating from AIG's own test, but adjusting fully for mark-to-market losses and stripping out goodwill and hybrid capital, even at the end of June AIG might have had about $24 billion less book equity than it needed to be safely capitalised. And some of its equity may be "trapped" within its insurance subsidiaries, whose capital positions are ringfenced by insurance regulators. That might leave the holding company that taxpayers have backed in a far worse state. On September 17th Eric Dinallo, New York's insurance regulator, vouched for the solvency of AIG's insurance subsidiaries but was more circumspect on the company overall.

Ultimately, though, AIG may turn out be worth something after all: in June it had $67 billion of tangible equity, a much bigger buffer relative to assets than existed at Lehman or Bear Stearns. And, says Andrew Rear of Oliver Wyman, a consultancy, AIG's insurance assets will attract a lot of interest. That raises the chances of their being sold at a premium, raising cash for the holding company. If the government holds on long enough, perhaps even AIG's CDS contracts might make money.

Derivatives

A nuclear winter?

Sep 18th 2008
From The Economist print edition

The fallout from the bankruptcy of Lehman Brothers

WHEN Warren Buffett said that derivatives were “financial weapons of mass destruction”, this was just the kind of crisis the investment seer had in mind. Part of the reason investors are so nervous about the health of financial companies is that they do not know how exposed they are to the derivatives market. It is doubly troubling that the collapse of Lehman Brothers and the near-collapse of American International Group (AIG) came before such useful reforms as a central clearing house for derivatives were in place.

A bankruptcy the size of Lehman’s has three potential impacts on the $62 trillion credit-default swaps (CDS) market, where investors buy insurance against corporate default. All of them would have been multiplied many times had AIG failed too. The insurer has $441 billion in exposure to credit derivatives. A lot of this was provided to banks, which would have taken a hit to their capital had AIG failed. Small wonder the Federal Reserve had to intervene.

The first impact concerns contracts on the debt of Lehman itself. As a “credit event”, the bankruptcy will trigger settlement of contracts, under rules drawn up by the International Swaps and Derivatives Association (ISDA). Those who sold insurance against Lehman going bust will lose a lot. But Lehman had looked risky for some time, so investors should have had the chance to limit their exposure.

The second effect relates to deals where Lehman was a counterparty, ie, a buyer or seller of a swaps contract. For example, an investor or bank may have bought a swap as insurance against an AIG default, with Lehman on the other side of the deal. That protection could conceivably be worthless if Lehman fails to pay up. Until the Friday before its bankruptcy, Lehman would have posted collateral, which the counterparty can claim. After that day, the buyer will have been exposed to price movements before it could unwind the contract.

The third effect will be on the collateralised-debt obligation (CDO) market, which caused so many problems last year. So-called synthetic CDOs comprise a bunch of credit-default swaps; a Lehman default may cause big losses for holders of the riskier tranches.

Insiders say the biggest exposure may be in the interest-rate swaps market, which is many times larger than those for credit derivatives. In a typical interest-rate swap, one party agrees to exchange a fixed-rate obligation with another that has a floating, or variable, rate exposure. Depending on whether floating rates rise or fall, one will end up owing money to the other. Again, those banks that dealt with Lehman should have been fine until Friday, when the bank was still posting collateral. But not afterwards.

Although there are ISDA rules to cover such events, the sheer size of Lehman in the market (its gross derivatives positions will be hundreds of billions of dollars) makes this default a severe test. There will inevitably be legal disputes as well. The good news is that the swaps markets did not utterly seize up after it went bust on September 15th. But the reaction may be a delayed one. Mr Buffett’s WMD could leave behind a cloud of toxicity.

European banks

Cross-border contagion

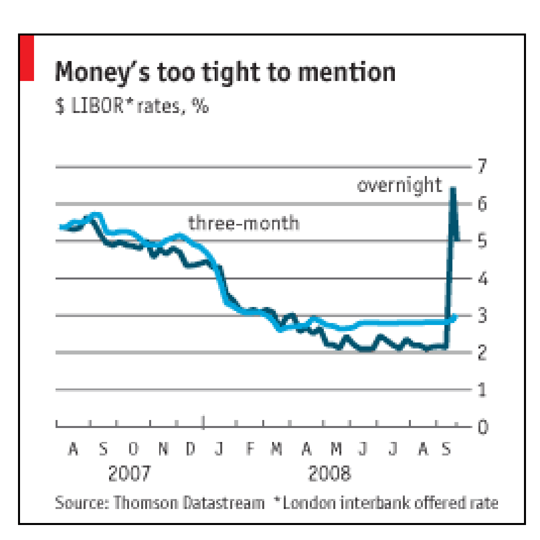
Sep 18th 2008
From The Economist print edition

HBOS's troubles give everyone a bit extra to worry about

JOHN PIERPONT MORGAN, it is said, whiled away the time while orchestrating a plan to avert the financial crisis of 1907 by steadfastly playing solitaire. A century later, the game *du jour* involves toying with dominoes. Funds and traders are casting about for the next banks to fall (and enthusiastically selling their shares).

So far most of the falling stones have been American. But some European banks are also teetering. The latest is HBOS, a well-capitalised but weakly funded British bank that will lose its independence. On September 18th HBOS, Britain's biggest mortgage lender, said it had agreed to be taken over by Lloyds TSB, another of the country's leading banks. There was government pressure, but both sides denied there had been a bail-out. Any hint of one would infuriate shareholders of Northern Rock, another British mortgage lender that was nationalised last year. They were largely wiped out.

Worries about the wholesale markets intensified, not just for HBOS, but all European banks, on September 16th, when Reserve Primary, a money-market fund, froze withdrawals for a week. Its troubles caused huge surges in the cost of borrowing money overnight (see chart). "I don't want to sound alarmist, but the liquidity squeeze we're experiencing now is worse than it was in August 2007 [at the start of the credit crunch]," observes one trader.



Although the shortage of money is most acute for dollar-denominated loans, some of Europe's biggest banks are also exposed to this market because they generally do not have dollar deposits and rely largely on money and capital markets to fund their investment banks. Among those affected are Barclays, Royal Bank of Scotland, Deutsche Bank and UBS, all of which saw huge jumps in the price of insuring their debt against default.

This reflected not just the spike in rates they are having to pay to borrow dollars (with some smaller outfits said to be paying as much as 12% for three-month money, according to money-market traders). There was also the worry that they face losses on loans and derivatives contracts with firms that are either bankrupt, such as Lehman, or suddenly less than creditworthy, such as AIG. Arturo De Frias of Dresdner Kleinwort estimates that European banks may end up with losses of about $31 billion on short-term loans to Lehman.

Just as big a concern for banks in Britain and Europe is whether the hotchpotch of regulatory systems across the continent could cope with a bank failure. The American authorities have been nimble enough, yet their agility has not quelled the panic. Their European counterparts are still arguing about who should be in charge and what should be done.

The trials of HBOS, which owns the Halifax, a building society, highlight a particular uncertainty faced by British banks. Even as the bank's share price and bond spreads weakened this week, the Bank of England dithered over whether to renew its facility for letting British banks swap mortgages for funds. It announced an extension on September 17th, after news of HBOS's talks with Lloyds had leaked out. British banks are also lobbying against parts of a long-overdue proposal by the authorities to deal with ailing banks.

For other European banks, there is trepidation not about whether their governments or central banks are willing to support them, but whether they can. Some of Europe's biggest banks, such as UBS, ING and Fortis, are based in some of its smallest countries such as Switzerland, the Netherlands and Belgium. If

one were to fail, the fallout might well make America's recent upheavals look orderly.

Emerging markets

Beware falling BRICs

Sep 18th 2008 | HONG KONG, DELHI AND SÃO PAULO
From The Economist print edition

Emerging countries are not the havens some people thought

SO MUCH for decoupling. In the wake of Lehman Brothers' failure, emerging markets have suffered one of their biggest sell-offs in years. On September 18th Russia's main bourses suspended trading in shares and bonds for a third day in a row after the largest one-day stockmarket fall for a decade; the central bank poured billions into big banks and the money market in a forlorn bid to calm fears. JPMorgan's emerging-markets bond index fell by more than 5% in the week to September 16th, giving up in a few days all the gains it had made this year. Prices of Argentina's credit-default swaps, a gauge of credit risk, rose to their highest-ever level. Unexpectedly, the People's Bank of China cut its benchmark lending rate by 27 basis points on September 15th, to 7.2%, the first cut for six years.

These actions reflected a variety of concerns, such as a darkening economic mood in China and political worries in Russia. But they all have something in common: investors may be changing their minds about emerging markets.

For the past few years, China, Brazil and others, with their high growth rates and large current-account surpluses, began to seem like desirable alternatives to developed markets. For part of last year, the MSCI emerging-markets index was even trading at a higher multiple of earnings than the index of rich-world shares.

That is changing as investors lose their appetite for risk. Merrill Lynch's most recent survey of fund managers found that they are now holding more bonds than normal for the first time in a decade (indicating a flight to safety). They also have smaller positions in emerging-market equities than at any time since 2001. In the past three months, says Michael Hartnett of Merrill Lynch, emerging-market funds have seen an outflow of $26 billion, compared with an inflow of $100 billion in the previous five years.

Falling oil and commodity prices are partly to blame. When these were rising, money poured into Brazil and Russia, which became targets of the "carry trade" (investors borrow in low-yielding currencies and buy high-yielding ones). Now oil prices are falling (dipping almost to $90 a barrel this week), they are undermining the carry trade and forcing Russia to prop up the rouble. Indebted investors are also being forced by their banks to sell as falling prices reduce the value of their collateral.

Reuters



The rouble in the rubble

Lower oil and commodity prices ought to benefit China and India, by lowering import bills and assuaging worries about inflation. Yet India's foreign-exchange reserves fell by $6.5 billion in the first week of September as the central bank sold dollars to slow the fall of the rupee. In China, worries are growing about weakening export demand (growth in export volumes has fallen by almost half over the past year to 11%) and falling property prices, which seem to play a role similar to equity prices elsewhere. In the past three months, property sales in big cities were 40-50% lower than a year ago, according to figures tracked by Paul Cavey of Macquarie Securities. An agent for one of Hong Kong's largest property companies says "confidence ended this week with the fall of Lehman."

All these countries have the comfort of huge foreign-exchange reserves. On September 16th the new governor of India's central bank said he would continue to cushion the rupee's fall; he also raised the interest rate Indian expatriates can earn on deposits at home and let banks borrow a bit more from the central bank. China's interest-rate cut shows that its government, too, has room for manoeuvre. But the cut will have little direct impact on the economy because lending is limited by quotas. It was intended to boost confidence at a time of falling

share and house prices. Too bad that among emerging-market investors, confidence is in short supply.

Accounting

All's fair

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From The Economist print edition

The crisis and fair-value accounting

Illustration by S. Kambayashi



SO CONTROVERSIAL has accounting become that even John McCain, a man not known for his interest in balance sheets, has an opinion. The Republican candidate for the American presidency thinks that "fair value" rules may be "exacerbating the credit crunch". His voice is part of a chorus of criticism against mark-to-market accounting, which forces banks to value assets at the estimated price they would fetch if sold now, rather than at historic cost. Some fear that accounting dogma has caused a cycle of falling asset prices and forced sales that endangers financial stability. The fate of Lehman Brothers and American International Group will have strengthened their conviction.

In response America's Financial Accounting Standards Board (FASB), and the London-based International Accounting Standards Board (IASB) have not budged an inch. So, for example, banks will have to mark their securities to the prices Lehman receives as it is liquidated. The two accounting bodies already act cheek by jowl, and America will probably soon adopt international rules. Are they guilty of obstinately pursuing an abstract goal that is causing mayhem in financial markets?

Banks' initial attack on fair value was self-serving. In April the Institute of International Finance (IIF), a lobbying group, sent a confidential memorandum to the two standard-setters. This said it was "obvious" markets had failed and that companies should be allowed to suspend fair value for "sound" assets that had suffered "undue valuation". Even at the time this stance lacked credibility; Goldman Sachs resigned from the IIF in protest at "Alice in Wonderland accounting". Today it is abundantly clear that those revelations were not a figment of accountants' imagination. For example, in July Merrill Lynch sold a big structured-credit portfolio at 22% of its face value—less than what was entered on its balance sheet. Bob Herz, FASB's chairman, argues that fair value is "essential to provide transparency" for investors.

Yet not all criticism of fair value can be so easily dismissed. The credit crunch has raised three genuinely awkward questions. The first of these concerns "procyclicality". Bankers say that in a downturn fair-value accounting forces them all to recognise losses at the same time, impairing their capital and triggering firesales of assets, which in turn drives prices and valuations down even more. Under traditional accounting, losses hit the books far more slowly. Some admire Spain's system, which requires banks to make extra provision for losses in good times, so that when loans turn sour their profits and thus capital fall by less.

It is too soon to know if prices exaggerate the ultimate losses on credit products. Some people argue that swift write-downs in fact help to re-establish stability: Yoshimi Watanabe, Japan's minister for financial services, says Japanese banks exacerbated their country's economic woes by "avoiding ever facing up to losses". But the principle defence of standard-setters is that enhancing financial stability is not the purpose of accounting.

Over to the regulators

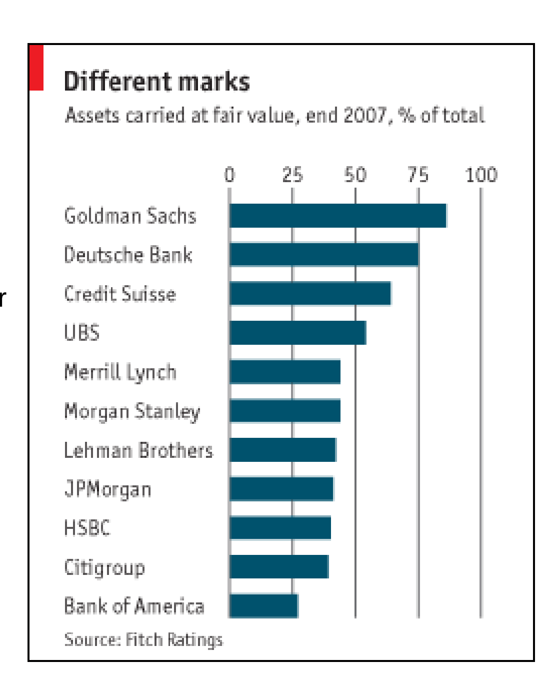
In other words, if procyclicality is a problem, it is someone else's. Already central banks have relaxed their rules on what they will accept from banks as collateral, which has helped to support the prices of risky assets. And the mayhem in the swaps market has shown the importance of on-exchange trading, so that trading remains orderly in times of stress.

Ultimately, though, responsibility for interposing a circuit-breaker between market prices and banks' capital adequacy falls on bank regulators, not accountants. They are already examining "countercyclical" regimes, which would force banks to save more capital in years of plenty. They could go further by suspending capital rules during times of stress if they think asset prices have overreacted. Europe's national regulators already use some discretion when defining capital adequacy. There is a precedent in pension regulation, where corporate schemes are marked to market but the cash payments companies make to keep them solvent are smoothed over time. Banks' financial statements could be modified to show assets at cost as well as fair value, so that if regulators or investors wanted to use traditional accounting to form a view, they could.

Even if they leave procyclicality to bank regulators, standard-setters still have a lot on their plates. The second—and immediate—question is how to value illiquid (and sometimes unique) assets. A common solution is to use banks' own models. But some investors are concerned that this gives banks' managers too much discretion—and no wonder, because highly illiquid (or "Level 3") assets are worryingly large relative to many banks' shrunken market values. Such is the complexity of many such assets that it may not be possible to find a generally acceptable method. The best answer is to disclose enough to allow investors to form their own views. This week IASB gave new guidance which should help in this regard.

The third problem is a longer-term one: the inconsistency of fair-value rules. Today the treatment of a financial asset is determined by the intention of the company. If it is to be traded actively, its market value must be used. If it is only "available for sale" it is marked to market on the balance sheet, but losses are not recognised in the income statement. If it is to be "held to maturity", or is a traditional loan, it can be carried at cost, subject to impairment. This is a dog's breakfast. Different banks can hold the same asset at different values. According to Fitch, a ratings agency, at the end of 2007, Western banks carried about half of their assets at fair value, but the dispersion was wide: from 86% at Goldman Sachs to 27% at Bank of America (see chart).

The obvious solution is to use fair value for all financial assets and liabilities. This is exactly what both FASB and IASB propose. In parallel they want to clean up the income statement, so that changes in the value of assets or liabilities are separated clearly from recurring revenues and costs.



For low-risk banks, this would make little difference: both HSBC and Santander report that the fair value of their loan books is slightly above their carrying value. But it could mean big losses for riskier institutions. When Bank of America bought Countrywide, a big mortgage lender, it was forced, under another quirk, to mark its troubled acquisition's loans at fair value, wiping out Countrywide's equity. Bankers are therefore likely to resist the idea of fair value for loans fiercely: one executive calls it "lunacy". Here standard setters' quest for intellectual consistency will run into a political quagmire.

Marks out of ten

Has accounting had a good credit crunch? The last year has shown that standard-setters are now truly independent and focused on investors' needs rather than the wishes of management, regulators and the taxman. Reforms to IASB's governance should bolster this independence. That is to be welcomed. For all fair value's flaws, banks ought not to have licence to carry their dodgy credit exposures at cost.

At the same time the fair-value revolution is incomplete. Regulators may need to abandon the traditional, mechanistic link between accounting and capital adequacy rules if they really want to try to fight banking crises. That is no bad thing either. Investors and regulators should be able to share a market-based language to describe financial problems, even if they disagree about what needs to be done.

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Economics focus

Beyond crisis management

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Bold ideas for solving America's financial mess

Illustration by Jac Depczyk



EVERY financial crisis involves a tug of war between the tacticians and the strategists. The tacticians dash from skirmish to skirmish trying to control a crisis, deciding in each case whether taxpayers should bail out a distressed bank, firm or country. The strategists call for a more comprehensive approach to resolving the mess—often involving new government bodies to recapitalise banks or take over troubled assets.

The present crisis in America conforms to this pattern. So far, the government's response has been ad hoc and focused on crisis containment. The tacticians at the Federal Reserve and the Treasury have put plenty of taxpayers' money on the line—whether through the huge expansion in the central bank's liquidity facilities, the loan to Bear Stearns in March, or the government takeover of Fannie Mae and Freddie Mac, the mortgage giants, and, now, of AIG, a huge insurer. But they have focused on staving off catastrophe one bail-out at a time.

Now the strategists are pushing back. From across the political spectrum people are arguing that it is time for America to shift to a more systematic approach. In the past week Barney Frank, the leading Democrat on financial matters in the House of Representatives, Paul Volcker, a former chairman of the Fed, as well as writers of the editorial pages of the *Wall Street Journal,* have suggested that Congress may need to create a new agency to deal with the mess. All have pointed to the Resolution Trust Corporation (RTC), a government body set up in 1989 to deal with the fallout of the savings and loan (S&L) bankruptcies.

Americans focus on the RTC because it is the country's most recent example of a comprehensive government plan to deal with a financial crisis. Between 1980 and 1994 almost 1,300 specialised mortgage lenders, known as thrifts, failed. Their combined assets amounted to more than $600 billion. By 1986 these failures had bankrupted the Federal Savings and Loan Insurance Corporation, the federal insurer for the thrift industry. At first the government tried to muddle through by trying to recapitalise the insurer. But the S&L mess escalated. In 1989 Congress created the RTC, an entirely new organisation, to dispose of the failed thrifts' assets in a way that minimised downward pressure on financial and property markets.

The RTC is not a perfect parallel for today's needs. It was set up—years after the S&L crisis began—to deal with the aftermath of widespread bank failures. Those who advocate comprehensive action today want to minimise the mess, not just clean up afterwards. Their proposals vary, but many who cite the RTC envisage an institution that buys troubled mortgage-backed securities (not only from failing institutions),

putting a floor under their price. Some propose that the putative new agency should manage and write down the underlying mortgages, in effect combining the functions of the RTC with a Depression-era institution, called the Home Owners' Loan Corporation, which bought and restructured defaulting mortgages. Details are in short supply, but intellectual momentum is building for a broader solution.

Not a moment too soon, suggest the results of a new study by Luc Laeven and Fabian Valencia, two IMF economists.* They examined all systemically important banking crises between 1970 and 2007, creating a database on how much financial crises cost and how they are resolved. The evidence is clear. Tactical crisis containment is expensive and frequently inadequate. In most financial meltdowns a comprehensive solution was required, and the sooner it was provided the better.

The study looks at 42 crises in all, spanning 37 countries. Like America today, most governments began with ad hoc crisis management. In 74% of cases, for instance, governments pumped emergency loans into failing banks or guaranteed their liabilities. An equally common tactic has been regulatory forbearance. Governments allowed banks to hold less capital than was normally required or softened their rules in other ways. These tactical responses, however, often did not work and ended up increasing the overall bill from a crisis. “All too often”, the economists conclude, “central banks privilege stability over cost in the heat of the containment phase.”

No such thing as a free crunch

Sooner or later most governments realise the need for a comprehensive solution to the crisis, involving public funds. This can take different forms, from bank recapitalisation to forgiveness of all the underlying debts. In three-quarters of the cases, governments shored up bank capital by, for instance, injecting preferred stock. About 60% of the time, governments set up institutions to manage distressed assets.

The evidence from these attempts is sobering for proponents of an RTC II. Some institutions worked well. In the early 1990s, for instance, Sweden successfully set up an asset-management company to take over and sell the bad loans from its biggest banks. But, in general, the paper argues, such government-owned asset-management firms are ineffective—often because politicians try to push them around.

On average, the study finds that government attempts to stanch systemic banking crises over the past three decades have cost 16% of GDP. That average hides enormous variation, much of which depends on how crises were handled. America's mess, even if it has already led to the demise of famous Wall Street firms, is far from finished. That is why the international lessons are worth taking seriously. Resolving a financial mess is cheaper, quicker and less painful if governments take a rounded approach. For the moment, the bail-out tacticians are in overdrive. But the strategists' moment is approaching.

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* “Systemic Banking Crises: a new database”. IMF Working Paper. September 2008.

Fishing and conservation

A rising tide

Sep 18th 2008
From The Economist print edition

AFP



Scientists find proof that privatising fishing stocks can avert a disaster

Get article background

FOR three years, from an office overlooking the Atlantic in Nova Scotia, Boris Worm, a marine scientist, studied what could prevent a fishery from collapsing. By 2006 Dr Worm and his team had worked out that although biodiversity might slow down an erosion of fish stocks, it could not prevent it. Their gloomy prediction was that by 2048 all the world's commercial fisheries would have collapsed.

Now two economists and a marine biologist have looked at an idea that might prevent such a catastrophe. This is the privatisation of commercial fisheries through what are known as catch shares or Individual Transferable Quotas (ITQs).

Christopher Costello and Steven Gaines (the biologist) of the University of California and John Lynham of the University of Hawaii assembled a database of the world's commercial fisheries, their catches and whether or not they were managed with ITQs. As these fisheries were not chosen at random and without having any experimental control, they borrowed techniques from medical literature—known as propensity-score matching and fixed-effects estimation—to support their analysis. The first method compared fisheries that are similar in all respects other than the use of ITQs; the second averaged the impact of ITQs over many fisheries and examined what happened after the quotas were introduced. Whichever way they analysed the data, they found that ITQs halted the collapse of fisheries (and according to one analysis even reversed the trend). The overall finding was that fisheries that were managed with ITQs were half as likely to collapse as those that were not.

For years economists and green groups such as Environmental Defense, in Washington, DC, have argued in favour of ITQs. Until now, individual fisheries have provided only anecdotal evidence of the system's worth. But by lumping all of them together the new study, published this week in *Science*, is a powerful demonstration that it really works. It also helps to undermine the argument that ITQ fisheries do better only because they are more valuable in terms of their fish stocks to begin with, says Dr Worm. The new data show that before their conversion, fisheries with ITQs were on exactly the same path to oblivion as those without.

Racing to fish

Encouraging as the results are, ITQ fisheries are in the minority. Most fisheries have an annual quota of what can be caught and other restrictions, such as the length of the season or the type of nets. But this can result in a “race to fish” the quota. Fishermen have an incentive to work harder and travel farther, which can lead to overfishing: a classic tragedy of the commons.

The use of ITQs changes this by dividing the quota up and giving shares to fishermen as a long-term right. Fishermen therefore have an interest in good management and conservation because both increase the value of their fishery and of their share in it. And because shares can be traded, fishermen who want to catch more can buy additional rights rather than resorting to brutal fishing tactics.

The Alaskan halibut and king crab fisheries illustrate how ITQs can change behaviour. Fishing in these waters had turned into a race so intense that the season had shrunk to just two to three frantic days. Overfishing was common. And when the catch was landed, prices plummeted because the market was flooded. Serious injury and death became so frequent in the king crab fishery that it turned into one of America’s most dangerous professions (and spawned its own television series, “The Deadliest Catch”).

After a decade of using ITQs in the halibut fishery, the average fishing season now lasts for eight months. The number of search-and-rescue missions that are launched is down by more than 70% and deaths by 15%. And fish can be sold at the most lucrative time of year—and fresh, so that they fetch a better price.

In a report on this fishery, Dan Flavey, a fisherman himself, says some of his colleagues have even pushed for the quota to be reduced by 40%. “Most fishermen will now support cuts in quota because they feel guaranteed that in the future, when the stocks recover, they would be the ones to benefit,” he says.

Although governing authorities are important in setting up ITQs, so is policing of the system by the fishermen themselves. In the Atlantic lobster fishery a property-based system has arisen spontaneously, says Dr Worm. Families claim ownership over parcels of sea and keep others out. Anyone trying to muscle in on the action risks being threatened; their gear may be cut loose or their boat could vanish.

Jeremy Prince, a fisheries scientist at Murdoch University in Australia, has been involved in ITQs since they were pioneered in the early 1980s by Australia, New Zealand and Iceland. In Australia they are only one way of managing with property rights, he says. Depending on the nature of a fishery, other methods may work better. These might divide up and sell lobster pots, numbers of fish, numbers of boats, bits of the ocean or even individual reefs. The best choice will depend on the value and underlying biology of each fishery, and in some places they may not work at all. In a fishery with a large, unproductive stock that grows slowly, fishermen may prefer short-term profit to the promise of low long-term income and catch all the fish straight away. Nevertheless, Dr Prince believes that, overall, market-based mechanisms are the way forward.

The most difficult place to introduce market-based conservation methods is in international waters. Attempts to do so have ended in failure. One problem is that there is simply too much cheating in the open ocean. Some scientists think a renegotiation of the law of the sea through the United Nations is the only way forward—or a complete ban on fishing in international waters. Although a dramatic course of action, the effects may not be so huge. Dr Worm reckons that 90% of the world’s fish are caught in national waters.

So, if Dr Costello and his colleagues are right and the profit motive can drive the sustainability of fisheries, why do the world’s 10,000-plus fisheries contain only 121 ITQs? Allocating catch shares is a difficult and often fraught process. In America it can take from five to 15 years, says Joe Sullivan, a partner in Mundt MacGregor, a law firm based in Seattle. The public, he says, sometimes resists the privatisation of a public resource and if government gets too involved in the details of the privatisation (rather than leaving it to the fishermen to work out), it can end up politically messy. But evidence that ITQs work is a powerful new hook to capture the political will and public attention needed to spread an idea that could avert an ecological disaster.

Sleep

Restless

Sep 18th 2008
From The Economist print edition

A strange case raises the question of what sleep is for

THE function of sleep, according to one school of thought, is to consolidate memory. Yet two Italians have no problems with their memory even though they never sleep. The woman and man, both in their 50s, are in the early stages of a neurodegenerative disease called multiple system atrophy. Their cases raise questions about the purpose of sleep.

Healthy people rotate between three states of vigilance: wakefulness, rapid eye-movement (REM) sleep and non-REM sleep. But all three are mixed together in the Italian patients. The pair were initially diagnosed by Roberto Vetrugno of the University of Bologna and his colleagues as suffering from REM behavioural disorder, in which the paralysis, or cataplexy, that normally prevents sleeping people from acting out their dreams is lost. This can cause people in REM sleep to twitch and groan, sometimes flailing about and injuring their bedmates. These patients, however, soon progressed from this state to an even odder one, according to a report in *Sleep Medicine*.

One of the principal ways to measure sleep is to monitor brainwave activity, which can be done by placing electrodes on the scalp in a technique known as electroencephalography (EEG). Non-REM sleep itself is divided into four stages defined purely by EEG patterns; the first two are collectively described as light sleep and the last two as deep or slow-wave sleep. When the Italian patients appeared to be asleep, their EEGs suggested that their brains were either simultaneously awake, in REM sleep and non-REM sleep, or switching rapidly between the three. Yet when subjected to a battery of neuropsychological tests, they showed no intellectual decline.

Mark Mahowald of the University of Minnesota Medical School, whose group first described REM behavioural disorder in 1986, thinks memory consolidation is still going on in the brains of the two Italian patients; hence their lack of cognitive impairment or dementia. What needs to be revised in light of their cases, he says, is the definition of sleep.

Dr Mahowald suspects that sleep can occur in the absence of the markers that currently define it, which means those markers are insufficient. What's more, the Italian cases lend support to an idea that has been gathering steam in recent years: that wakefulness and sleep are not mutually exclusive. In other words, the human brain can be awake and asleep at the same time.

That evidence takes the form of a growing list of conditions in which wakefulness, REM and non-REM sleep appear to be mixed. An example is narcolepsy, in which emotionally laden events trigger sudden cataplexy. When the dreaming element of REM intrudes into wakefulness, which can happen with sleep-deprivation, the result is wakeful dreaming or hallucinations. Since such dreams can be highly compelling, Dr Mahowald thinks they might account for some reports of alien abduction.

But there is another possible explanation of the Italian puzzle: that sleep is not necessary for memory after all. Jerry Siegel of the University of California, Los Angeles, has studied the sleep habits of many animals and thinks that could well be the explanation. All of which gives researchers something new to keep them awake at night.

Economist.com SCIENCE & TECHNOLOGY

Children's health

Worries in a bottle

Sep 18th 2008
From The Economist print edition

Jupiter Images



Are commonly used plastics and medicines harming human health?

IT IS a family nightmare. New parents try to eliminate potential hazards from their children's lives, but what if hidden dangers lurk in the use of everyday objects and familiar substances, like plastics or medicines? Just imagine if baby-feeding bottles harmed infants' health, or if a painkiller widely administered to children ended up doing more harm than good.

Activists have long raised concerns about the poorly understood links between the environment and health. Some worry about toxins in the air and the overuse of plastics, while others fret that children are overmedicated. Regulators and industry officials have pooh-poohed such talk, but several studies released this week may lead them to reconsider.

A frequent cause for concern has been bisphenol-A (BPA), a commonly used plastic. The Work Group for Safe Markets, a coalition of American charities and lobbying groups, earlier this year issued a report called "Baby's Toxic Bottle" that suggested BPA leaches into milk when bottles are heated. Others worry that adults have been harmed by this plastic too, since it is often used to line the inside of drink cans.

Such worries were easily dismissed because they were not backed by scientific evidence—at least until now. A study published this week in the *Journal of the American Medical Association* analyses the most comprehensive set of data that tracks both a variety of health indicators and concentrations of BPA in urine. The latter matters because when this plastic is absorbed, it quickly passes through the body.

The researchers, led by Iain Lang of Peninsula Medical School at Exeter in south-west England, found that higher urinary concentrations of BPA were associated with heart problems, diabetes and liver complications. They did not find such a correlation with other diseases. Although the study did not include infants, parents using BPA bottles are unlikely to be reassured by these findings.

A separate study in the *Lancet* will also come as little comfort. A team led by Richard Beasley of the Medical Research Institute of New Zealand studied the link between the use of paracetamol, a painkiller frequently used for young children, and asthma. After scrutinising the health data for children aged six and seven participating in the International Study of Asthma and Allergies in Childhood, they draw a sobering conclusion: use of this drug to tame fevers in children under the age of one is associated with an increased risk of their having asthma when they are six.

So, is this all doom and gloom for parents? Not necessarily. For one thing, these studies are not the final word on a very complex subject. The authors of the paper on paracetamol, for example, admit that "causality cannot be established" from a statistical study such as theirs; to determine whether the link is coincidence or causation, they recommend randomised control trials that look carefully into the long-term effects of paracetamol use. The BPA paper also acknowledges that independent replication and follow-up

studies are needed. Another complication is that even a link between asthma and paracetamol needs to be put into the proper context. Any demonstrable harm caused by the use of plastics and painkillers has to be weighed against the benefits they bring, such as reliability and efficacy. They also need to be weighed against the costs and benefits of alternatives.

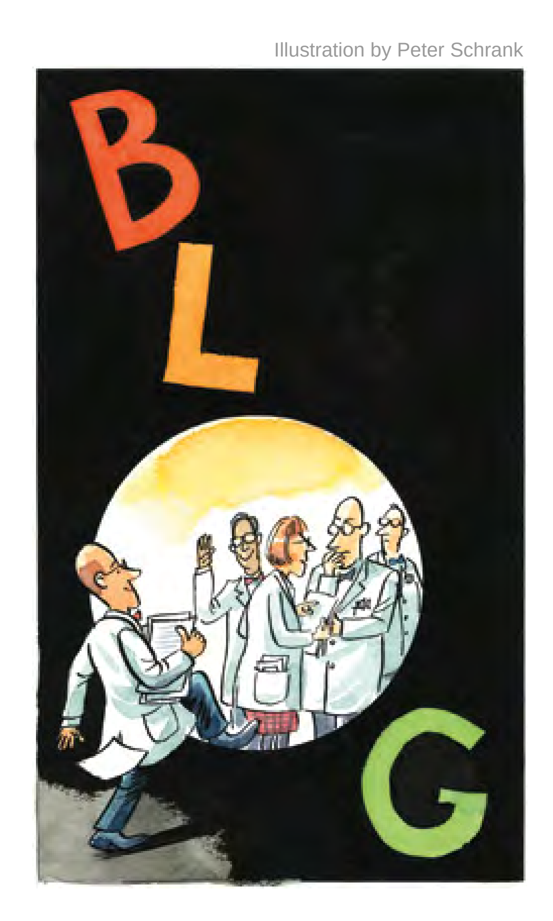
Simply abandoning two familiar tools of parenthood in a panic might make matters worse: suppose, say, BPA were replaced with new materials that eventually turned out to have even more worrying properties. This week's studies, although not definitive, do provide enough reason for researchers to redouble their efforts to understand the complex links between a child's early life and its later health.

Scientific publishing

User-generated science

Sep 18th 2008
From The Economist print edition

Illustration by Peter Schrank



Web 2.0 tools are beginning to change the shape of scientific debate

IN PRE-INTERNET times, peer-reviewed journals were the best way to disseminate research to a broad audience. Even today, editors and reviewers cherry-pick papers deemed the most revelatory and dispatch them to interested subscribers worldwide. The process is cumbersome and expensive, but it has allowed experts to keep track of the most prominent developments in their respective fields.

Peer-review possesses other merits, the foremost being the ability to filter out dross. But alacrity is not its strong suit. With luck a paper will be published several months after being submitted; many languish for over a year because of bans on multiple submissions. This hampers scientific progress, especially in nascent fields where new discoveries abound. When a paper does get published, the easiest way to debate it is to submit another paper, with all the tedium that entails.

Now change is afoot. Earlier this month Seed Media Group, a firm based in New York, launched the latest version of Research Blogging, a website which acts as a hub for scientists to discuss peer-reviewed science. Such discussions, the internet-era equivalent of the journal club, have hitherto been strewn across the web, making them hard to find, navigate and follow. The new portal provides users with tools to label blog posts about particular pieces of research, which are then aggregated, indexed and made available online.

Although Web 2.0, with its emphasis on user-generated content, has been derided as a commercial cul-de-sac, it may prove to be a path to speedier scientific advancement. According to Adam Bly, Seed's founder, internet-aided interdisciplinarity and globalisation, coupled with a generational shift, portend a great revolution. His optimism stems in large part from the fact that the new technologies are no mere newfangled gimmicks, but spring from a desire for timely peer review.

However, what Dr Bly calls Science 2.0 has drawbacks. Jennifer Rohn, a biologist at University College London and a prolific blogger, says there is a risk that rivals will see how your work unfolds and pip you to the post in being first to publish. Blogging is all well and good for tenured staff but lower down in the academic hierarchy it is still publish or perish, she laments.

To help avoid such incidents Research Blogging allows users to tag blog posts with metadata, information about the post's author and history. This enables priority of publication to be established, something else peer-reviewed journals have long touted as their virtue.

Coming home to roost

With the technology in place, scientists face a chicken-and-egg conundrum. In order that blogging can become a respected academic medium it needs to be recognised by the upper echelons of the scientific establishment. But leading scientists are unlikely to take it up until it achieves respectability. Efforts are under way to change this. Nature Network, an online science community linked to *Nature*, a long-established science journal, has announced a competition to encourage blogging among tenured staff. The winner will be whoever gets the most senior faculty member to blog. Their musings will be published in the *Open Laboratory*, a printed compilation of the best science writing on blogs. As an added incentive, both blogger and persuader will get to visit the Science Foo camp, an annual boffins' jamboree in Mountain View, California.

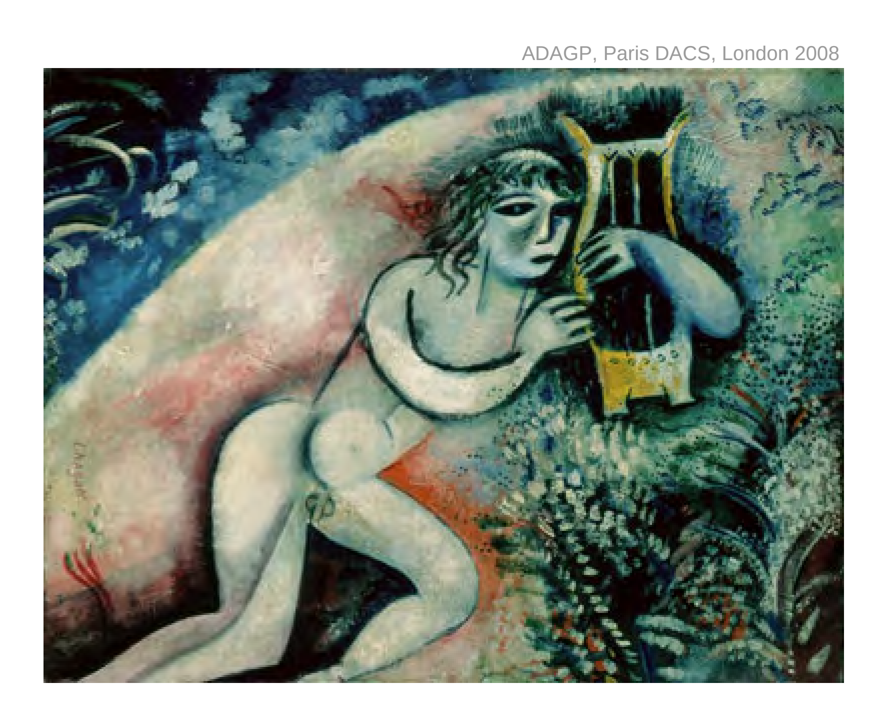
By itself this is unlikely to bring an overhaul of scientific publishing. Dr Bly points to a paradox: the internet was created for and by scientists, yet they have been slow to embrace its more useful features. Nevertheless, serious science-blogging is on the rise. The *Seed* state of science report, to be published later this autumn, found that 35% of researchers surveyed say they use blogs. This figure may seem underwhelming, but it was almost nought just a few years ago. Once the legion of science bloggers reaches a critical threshold, the poultry problem will look paltry.

Economist.com BOOKS & ARTS

Marc Chagall

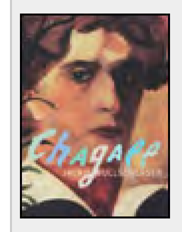
Fiddlers and floating brides

Sep 18th 2008
From The Economist print edition



An early artistic genius, Marc Chagall painted on for far too long

Chagall: A Biography
By Jackie Wullschlager



Knopf; 608 pages; $40. Allen Lane; £30

Buy it at
Amazon.com
Amazon.co.uk

WHAT is artistic success? Marc Chagall rose from obscurity in the Jewish Pale of tsarist Russia to become a multimillionaire and global art celebrity. He was a young star wherever new art was hot: Paris in 1911-12; revolutionary Russia; early-1920s Berlin. Popular taste canonised him in old age as a founder, with Henri Matisse and Pablo Picasso, of French modernism. Patrons for his big public commissions included the Catholic church, the Israeli state, the Rockefellers, the Paris opera and the United Nations.

A strong-minded mother and a succession of three attentive wives ensured him unbroken feminine care. A political *naïf*, he left it to luck to waltz him clear of Bolshevik hard men in Soviet Russia and of anti-Semitic policemen in Vichy France. At ease under the sunshine of Provence in 1985, a painless heart attack felled him at the age of 97 after a quiet day in the studio.

A jammy life, you might think on finishing Jackie Wullschlager's first-rate biography. And in a sense it was. Smiling out at us in photographs of the old man is not someone racked by might-have-beens but a white-haired faun with twinkling eyes. Ms Wullschlager, art critic for the *Financial Times* (owned by Pearson, as this newspaper partly is too), gives us sympathetically and in full a man whom friends and rivals alike remembered for his gentle charm.

"Chagall: A Biography" also looks hard at the work. Here the image of enchanted genius and Chagall's actual achievement begin to slip apart. Though Ms Wullschlager is fair and never sneering about his painting after he left Russia for ever in 1922, she is firm that his art was never as good again.

Till then he combined Russian and French art in unique scenes of *shtetl* life at once realistic and magical, personal and archetypical, with floating brides, upside-down people, fiddlers on roofs and calves in cow's bellies. When in 1912 Guillaume Apollinaire saw Chagall's dreamlike images at his Montparnasse studio, he murmured, according to Chagall, "*Surnaturel*". The phrase went round Paris, surrealism acquired an origin myth and Chagall's reputation was made.

Back in Russia, at his home town of Vitebsk and then in St Petersburg (then called Petrograd), he worked on through war and revolution with equal fire, using cardboard when canvas was scarce. Then things go suddenly and permanently wrong. Artistic grace vanishes as mysteriously as it came. Chagall never lost his feel for colour. But structure, content and invention weaken calamitously. Without claiming to explain what probably nobody can explain, Ms Wullschlager records Chagall's artistic slide into repetition, pastiche and sentimentality.

There are still almost 70 years, close on half the book, to go. But having read her wonderful evocation of Jewish Vitebsk, tsarist St Petersburg and modernist Paris, having lived as in a novel with the Hasidic families of Chagall and Bella Rosenfeld, his first wife, the reader will be hooked.

Vivid personalities, constant upheavals and Chagall's scarcely believable blunders make for barely a dull page. In the graphic work he did between the wars for his dealer-friend, Ambroise Vollard—illustrations to Gogol, La Fontaine and the Bible—grace intermittently returns.

Chagall welcomed the Russian revolution, but found himself a clay jug among iron pots. He ran a Bolshevik art school in Vitebsk with Kasimir Malevich and Lazar El Lissitzky, two avant-garde tough nuts who bullied him out of his director's job. Back in Moscow he slipped from one precarious commission to another. In Vitebsk synagogues closed. The secret police raided Bella's family jewellery shop. At her prodding, the couple joined Russia's cultural exodus, to Berlin and then Paris.

Precious work Chagall had left behind before the war was gone. Some he had trusted to a Berlin dealer, the rest he had stored in his Paris studio behind a door tied with string. He set to recreating what he had lost. Many Chagalls on museum walls are his 1920s copies. He wrote a memoir of his youth. Already he was looking back.

Blithe to Stalin, Chagall sent a reckless letter in 1937 to his art teacher in Vitebsk that probably cost the old man his life at the hands of the secret police. Blind to danger, Chagall lingered in France until July 1941. The day that he and Bella left Marseille for America, the Vichy police deported 1,200 other Jewish refugees there to forced labour in north Africa.

Bella's sudden death in 1944 left Chagall, who had no English, quite helpless. He married again, divorced and married a lasting helpmate for old age, Vava Brodsky. Bella was Chagall's muse. Vava was his manager, turning the studio—with his backing—into a business. Picasso, who did not like Chagall's work, teased him about his high prices.

His shrewder friends recognised strategy in Chagall's innocence. Ms Wullschlager notes it too, but likes him nonetheless. For the under-documented early years she leans inevitably on his inventive "My Life" (1931). Later she has family letters and interviews to rely on.

Though not claiming to explain the later failures, Ms Wullschlager hints at three conditions for the early success. Those conditions came happily together in Chagall's wonder years of 1911-17: new idioms in art, the persistence of Hasidic life in the *shtetl*, and an artist who found distance enough to reconfigure that life in the universal medium of paint. There is no proof in such matters, but Ms Wullschlager's idea is very plausible—and sends you back to Chagall's unique youthful burst of colour and invention.

Chagall: A Biography.
By Jackie Wullschlager.
Knopf; 608 pages; $40. Allen Lane; £30

New jihadism

Blood-stained pursuit of revenge

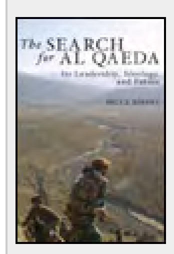
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Reuters



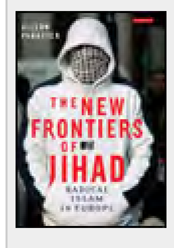
A minority within a minority

The Search for Al Qaeda: Its Leadership, Ideology, and Future
By Bruce Riedel



Brookings Institution Press; 224 pages; $26.95 and £15.99

The New Frontiers of Jihad: Radical Islam in Europe
By Alison Pargeter



University of Pennsylvania Press; 256 pages; $34.95. I.B. Tauris; £18.99

MOUNTAINS of books and articles have been written on violent jihadism. But seven years after the September 11th attacks on America, the experts still disagree on basic issues. These two books, for instance, even offer different interpretations of the starting point: what was al-Qaeda's aim in carrying out the "Manhattan raid" in 2001?

For Bruce Riedel, a former CIA officer and White House adviser, al-Qaeda sought deliberately "to lure the United States into an invasion first of Afghanistan and then of Iraq", and thus exhaust the superpower in "bleeding wars" of the kind that defeated the Soviet Union in Afghanistan in 1989. The ineptitude of the Bush administration and its "botched" occupation of two Muslim countries reinforced al-Qaeda, which Mr Riedel describes as "the first truly global terrorist organisation in history."

But in the view of Alison Pargeter, a researcher at Britain's Cambridge University, it is Osama bin Laden who was naive: remembering America's earlier flights from Lebanon and Somalia, he thought that a devastating blow on American soil would force it to withdraw its forces from Saudi Arabia. Instead al-Qaeda suffered a "tactical disaster" when America's invasion toppled the Taliban and evicted al-Qaeda from Afghanistan. But a tactical disaster only: Ms Pargeter goes on to argue that on the ideological plane the attacks on America turned out to be a masterstroke, showing a new way of punishing "the symbols of oppression" and taking "revenge on behalf of the entire Muslim population".

Mr Riedel gives a top-down account of jihadism through profiles of key al-Qaeda leaders: Mr bin Laden; his Egyptian deputy, Ayman al-Zawahiri; Mullah Omar, the Taliban leader; and Abu Musab al-Zarqawi, the late leader of al-Qaeda's especially vicious Iraq branch. By contrast, Ms Pargeter adopts a bottom-up approach in analysing the many strands of Islamist ideology as it has manifested itself in Europe, whether in the Madrid and London bombings, or the culture wars over Salman Rushdie's books and Danish newspaper cartoons depicting the Prophet Muhammad.

Mr Riedel concludes that the source of al-Qaeda's ideological fervour is the Israeli-Arab conflict, the central "all-consuming issue" for al-Qaeda. This contradicts many members of the Bush administration who contend that Palestine has little to do with today's problems in the Middle East.

Ms Pargeter, too, may jolt some in her European audience by dismissing many of the common explanations for Muslim radicalisation. It is not, she argues, a reaction to the invasions of Afghanistan and Iraq, given that many of those involved in acts of violence turned radical before those wars. Nor is it simply a manifestation of deprivation and social alienation, let alone a straight reaction to racism and "Islamophobia", a term that in her view is much shouted about by those seeking to accentuate a separate Islamic identity. She also shrugs off the criticism that Britain's multiculturalism has allowed Muslims to detach themselves from their fellow citizens. Countries such as France, which demand a much greater degree of integration, are similarly plagued by extremism.

All these factors aggravate matters but only by reinforcing the underlying ideology that blames the ills of the Muslim world on the nefarious actions of the West. This is a belief, she argues, bred out of "stagnation and crisis" in Muslim countries, and then exported to European soil. Muslim immigrants, and often their offspring too, remain culturally and religiously rooted in their countries of origin and mimic those countries' political trends. Muslim groups in Europe are still led for the most part by first-generation migrants, and the most authoritative religious rulings emanate from figures in Muslim countries.

The aim for today's jihadists, says Ms Pargeter, is "the creation of a revolutionary state" to bring Islamic justice to the world. She provides a detailed, political scientist's analysis. Yet she still struggles, as do others, to explain why "the new generation of jihadists appears to have descended into a nihilistic kind of violence," which is driven by revenge rather than by more tangible and political objectives.

Of the two books, Ms Pargeter's work is the more nuanced and could well become a seminal work on Islamist radicalism in Europe. Mr Riedel argues that a new American president should tackle al-Qaeda by undermining the "narrative" of Muslim oppression. He provides several sensible recommendations, such as making a renewed effort to settle the festering disputes over Palestine and Kashmir. Ms Pargeter offers little in the way of prescription.

She is right, though, to give warning that Muslims in Europe should not be seen as a single undifferentiated group or, at most, as two camps of "extremists" and "moderates". In her view, those who define themselves first and foremost as Muslims—rather than as Egyptians, Pakistanis, or even British and French—are a minority. Violent jihadists are therefore a minority within a minority, as are "moderate" Islamists who some governments are trying to bolster as a counterweight to jihadists. To lump even jihadists together as a single globalised movement is unwittingly to abet their propaganda and strengthen their bleak division of the world into Muslims and unbelievers.

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The English language

The secret life of words

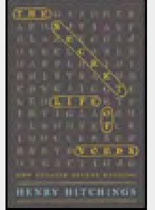
Sep 18th 2008
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MANY will know that the word "muscle" comes from the Latin for "mouse" (rippling under the skin, so to speak). But what about "chagrin", derived from the Turkish for roughened leather, or scaly sharkskin. Or "lens" which comes from the Latin "lentil" or "window" meaning "eye of wind" in old Norse? Looked at closely, the language comes apart in images, like those strange paintings by Giuseppe Arcimboldo where heads are made of fruit and vegetables.

Illustration by Daniel Pudles



The Secret Life of Words: How English Became English
By Henry Hitchings



Farrar, Straus and Giroux; 440 pages; $27. John Murray; £16.99

Buy it at
Amazon.com
Amazon.co.uk

Not that Henry Hitchings's book is about verbal surrealism. That is an extra pleasure in a book which is really about the way the English language has roamed the world helping itself liberally to words, absorbing them, forgetting where they came from, and moving on with an ever-growing load of exotics, crossbreeds and subtly shaded near-synonyms. It is also about migrations within the language's own borders, about upward and downward mobility, about words losing their roots, turning up in new surroundings, or lying in wait, like "duvet" which was mentioned by Samuel Johnson, for their moment.

All this is another way of writing history. The Arab etymologies of "saffron", "crimson" and "sugar" speak of England's medieval trade with the Arab world. We have "cheque" and "tariff" from this source too, plus "arithmetic" and "algorithm"—just as we have "etch" and "sketch" from the Dutch, musical terms from the Italians and philosophical ones from the Germans. French nuance and finesse are everywhere. At every stage, the book is about people and ideas on the move, about invasion, refugees, immigrants, traders, colonists and explorers.

This is a huge subject and one that is almost bound to provoke question-marks and explosions in the margins—soon forgotten in the book's sheer sweep and scale. A balance between straight history and word history is sometimes difficult to strike, though. There is a feeling, occasionally, of being bundled too fast through complex linguistic developments and usages, or of being given interesting slices of history for the sake, after all, of not much more than a "gong" or a "moccasin". But it is churlish to carp. The author's zest and grasp are wonderful. He makes you want to check out everything—"carp" and "zest" included. Whatever is hybrid, fluid and unpoliced about English delights him.

English has never had its Académie Française, but over the centuries it has not lacked furious defenders against foreign "corruption". There have been rearguard actions to preserve its "manly" pre-Norman origins, even to reconstruct it along Anglo-Saxon lines: "wheel-saddle" for bicycle, "painlore" for pathology. But the omnivorous beast is rampant still. More people speak it as their second language than as their first. Forget the language of Shakespeare. It's "Globish" now, the language of aspiration. No one owns it, a cause for despair to some. Mr Hitchings admits to wincing occasionally, but almost on principle he is more cheerful than not.

The Secret Life of Words: How English Became English.
By Henry Hitchings.
Farrar, Straus and Giroux; 440 pages; $27. John Murray; £16.99

Barack Obama

Here's looking at you, kid

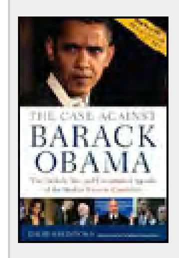
Sep 18th 2008
From The Economist print edition

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IF YOU find yourself believing that “we are the ones we’ve been waiting for”, or that “this is the moment when the rise of the oceans began to slow” or even, *tout court*, that “yes we can”, the chances are that you are suffering from a severe case of Obamamania.

Tens of millions of Americans and an even larger number of Europeans have fallen victim to the syndrome, which involves a belief that a young black senator from Chicago can cure the world’s ills, in part because of his race, in part because of his obvious intelligence and rhetorical skill; but in no part because of any record of achievement in the past. Fortunately, an inexpensive remedy is at hand.

The Case Against Barack Obama: The Unlikely Rise and Unexamined Agenda of the Media's Favorite Candidate
By David Freddoso



Regnery; 290 pages; $27.95 and £16.99

Buy it at
Amazon.com
Amazon.co.uk

It comes in the form of a new book by David Freddoso, “The Case Against Barack Obama”. Unlike the authors of some of the cruder attacks on Mr Obama, Mr Freddoso works for a well-respected organisation, the online version of the *National Review*. Although it is a conservative publication and the author makes no secret of where his political sympathies lie, this is a well-researched, extensively footnoted work. It aims not so much to attack Mr Obama as to puncture the belief that he is in some way an extraordinary, mould-breaking politician.

The Obama that emerges from its pages is not, Mr Freddoso says, “a bad person. It’s just that he’s like all the rest of them. Not a reformer. Not a Messiah. Just like all the rest of them in Washington.” And the author makes a fairly compelling case that this is so. The best part of the book concentrates on Mr Obama’s record in Chicago, his home town and the place from which he was elected to the Illinois state Senate in 1996, before moving to the United States Senate in 2004. The book lays out in detail how this period began in a way that should shock some of Mr Obama’s supporters: he won the Democratic nomination for his Illinois seat by getting a team of lawyers to throw all the other candidates off the ballot on various technicalities. One of those he threw off was a veteran black politician, a woman who helped him get started in politics in the first place.

If Mr Obama really were the miracle-working, aisle-jumping, consensus-seeking new breed of politician his spin-doctors make him out to be, you would expect to see the evidence in these eight years. But there isn’t very much. Instead, as Mr Freddoso rather depressingly finds, Mr Obama spent the whole period without any visible sign of rocking the Democratic boat.

He was a staunch backer of Richard Daley, who as mayor failed to stem the corruption that has made Chicago one of America’s most notorious cities. Nor did he lift a finger against John Stroger and his son Todd, who succeeded his father as president of Cook County’s Board of Commissioners shortly before Stroger senior died last January. Cook County, where Chicago is located, has been extensively criticised for corrupt practices by a federally appointed judge, Julia Nowicki.

The full extent of Mr Obama’s close links with two toxic Chicago associates, a radical black preacher, Jeremiah Wright, and a crooked property developer, Antoin Rezko, is also laid out in detail. The Chicago section is probably the best part of the book, though the story continues: once he got to Washington, DC, Mr Obama’s record of voting with his party became one of the most solid in the capital. Mr Freddoso notes that he did little or nothing to help with some of the great bipartisan efforts of recent years, notably on immigration reform or in a complex battle over judicial nominations.

Sometimes, however, Mr Freddoso lets his own partisan nature run away with him. It strikes the reader as odd to make an issue out of the Obamas' comfortable income, when everyone knows that John McCain and Hillary Clinton both have family fortunes in excess of $100m. On the whole, though, Mr Freddoso raises legitimate points. And he ends with a question Obamamaniacs should ask themselves more often: "Do you hope that Barack Obama will change politics if he becomes president? On what grounds?"

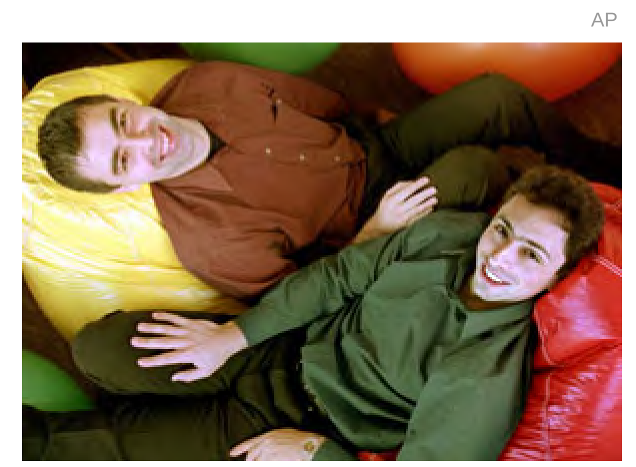
The Case Against Barack Obama: The Unlikely Rise and Unexamined Agenda of the Media's Favorite Candidate.
By David Freddoso.
Regnery; 290 pages; $27.95 and £16.99

Google

The quest

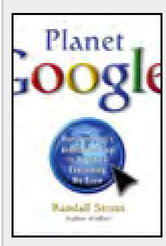
Sep 18th 2008
From The Economist print edition

AP



Big Brothers to us all

Planet Google: One Company's Audacious Plan to Organize Everything We Know
By Randall Stross



Free Press; 288 pages; $26. Atlantic Books; £16.99

GOOGLE must be the most ambitious company in the world. Its stated goal, "to organise the world's information and make it universally accessible and useful," deliberately omits the word "web" to indicate that the company is reaching for absolutely all information everywhere and in every form. From books to health records and videos, from your friendships to your click patterns and physical location, Google wants to know. To some people this sounds uplifting, with promises of free access to knowledge and help in managing our daily lives. To others, it smacks of another Big Brother, no less frightening than its totalitarian ancestors for being in the private sector.

Randall Stross, a journalist at the *New York Times*, does a good job of analysing this unbounded ambition by organising Google's quest into its thematic components. One chapter is about the prodigious data centres that Google is building with a view to storing all that information, another about the algorithms at the heart of its web search and advertising technology, another about its approach to dead-tree information bound in books, its vision for geographical information and so forth. He is at his best when explaining how Google's mission casually but lethally smashes into long-existing institutions such as, say, copyright law or privacy norms.

And yet, unfathomably, he mostly omits the most fascinating component of Google, its people. Google is what it is because of its two founders, Sergey Brin and Larry Page, who see themselves as benevolent über-geeks and embody the limitless optimism about science, technology and human nature that is native to Silicon Valley. The world is perfectible, and they are the ones who will do much of the perfecting, provided you let them.

Messrs Brin and Page set out to create a company and an entire culture in their image. From the start, they professed that they would innovate as much in managing—rewarding, feeding, motivating, entertaining and even transporting (via Wi-Fi-enabled free shuttle buses) their employees—as they do in internet technology. If Google is in danger of becoming a caricature, this is first apparent here—in the over-engineered day-care centres, the shiatsu massages and kombucha teas. In reality Googlers are as prone to turf wars and office politics as anyone else.

None of that makes it into Mr Stross's account, which at times reads like a diligent summary of news articles. At those moments, "Planet Google" takes a risk akin to trying to board a speeding train: the Google story changes so fast that no book can stay up to date for long. Even so, a sober snapshot of this moment in Google's quest is welcome. Especially since Google fully expects, as its chief executive, Eric Schmidt, says at the end of the book, to take 300 years completing it.

Planet Google: One Company’s Audacious Plan to Organize Everything We Know.
By Randall Stross.
Free Press; 288 pages; $26. Atlantic Books; £16.99

Martin Tytell

Sep 18th 2008
From The Economist print edition

eyevine



Martin Tytell, a man who loved typewriters, died on September 11th, aged 94

ANYONE who had dealings with manual typewriters—the past tense, sadly, is necessary—knew that they were not mere machines. Eased heavily from the box, they would sit on the desk with an air of expectancy, like a concert grand once the lid is raised. On older models the keys, metal-rimmed with white inlay, invited the user to play forceful concertos on them, while the silvery type-bars rose and fell chittering and whispering from their beds. Such sounds once filled the offices of the world, and Martin Tytell's life.

Everything about a manual was sensual and tactile, from the careful placing of paper round the platen (which might be plump and soft or hard and dry, and was, Mr Tytell said, a typewriter's heart) to the clicking whirr of the winding knob, the slight high conferred by a new, wet, Mylar ribbon and the feeding of it, with inkier and inkier fingers, through the twin black guides by the spool. Typewriters asked for effort and energy. They repaid it, on a good day, with the triumphant repeated ping! of the carriage return and the blithe sweep of the lever that inched the paper upwards.

Typewriters knew things. Long before the word-processor actually stored information, many writers felt that their Remingtons, or Smith-Coronas, or Adlers contained the sum of their knowledge of eastern Europe, or the plot of their novel. A typewriter was a friend and collaborator whose sickness was catastrophe. To Mr Tytell, their last and most famous doctor and psychiatrist, typewriters also confessed their own histories. A notice on his door offered "Psychoanalysis for your typewriter, whether it's frustrated, inhibited, schizoid, or what have you," and he was as good as his word. He could draw from them, after a brief while of blue-eyed peering with screwdriver in hand, when they had left the factory, how they had been treated and with exactly what pressure their owner had hit the keys. He talked to them; and as, in his white coat, he visited the patients that lay in various states of dismemberment on the benches of his chock-full upstairs shop on Fulton Street, in Lower Manhattan, he was sure they chattered back.

A drawer of umlauts

His love affair had begun as a schoolboy, with an Underwood Five. It lay uncovered on a teacher's desk, curved and sleek, the typebars modestly contained but the chrome lever gleaming. He took it gently apart, as far as he could fillet 3,200 pieces with his pocket tool, and each time attempted to get further.

A repair man gave him lessons, until he was in demand all across New York. When he met his wife Pearl later, it was over typewriters. She wanted a Royal for her office; he persuaded her into a Remington, and then marriage. Pearl made another doctorly and expert presence in the shop, hovering behind the overflowing shelves where the convalescents slept in plastic shrouds.

Mr Tytell could customise typewriters in all kinds of ways. He re-engineered them for the war-disabled and for railway stations, taking ten cents in the slot. With a nifty solder-gun and his small engraving lathe he could make an American typewriter speak 145 different tongues, from Russian to Homeric Greek. An idle gear, picked up for 45 cents on Canal Street, allowed him to make reverse carriages for right-to-left Arabic and Hebrew. He managed hieroglyphs, musical notation and the first cursive font, for Mamie Eisenhower, who had tired of writing out White House invitations.

When his shop closed in 2001, after 65 years of business, it held a stock of 2m pieces of type. Tilde "n"s alone took up a whole shelf. The writer Ian Frazier, visiting once to have his Olympia cured of a flagging "e", was taken into a dark nest of metal cabinets by torchlight. There he was proudly shown a drawer of umlauts.

Mr Tytell felt that he owed to typewriters not only his love and his earnings, but his life. In the second world war his knowledge of them had saved him from deploying with the marines. Instead he spent his war turning Siamese keyboards into 17 other Asian languages, or customising typewriters for future battlegrounds. His work sometimes incidentally informed him of military planning; but he kept quiet, and was rewarded in 1945 with a medal done up on a black, familiar ribbon.

Each typewriter was, to him, an individual. Its soul, he reminded Mr Frazier, did not come through a cable in the wall, but lay within. It also had distinguishing marks—that dimple on the platen, that sluggishness in the typebars, that particular wear on the "G", or the "t"—that would be left, like a fingerprint, on paper. Much of Mr Tytell's work over the years was to examine typewritten documents for the FBI and the police. Once shown a letter, he could find the culprit machine.

It was therefore ironic that his most famous achievement was to build a typewriter at the request of the defence lawyers for Alger Hiss, who was accused in 1948 of spying for the Soviet Union. His lawyers wanted to prove that typewriters could be made exactly alike, in order to frame someone. Mr Tytell spent two years on the job, replicating, down to the merest spot and flaw, the Hiss Woodstock N230099. In effect, he made a perfect clone of it. But it was no help to Hiss's appeal; for Mr Tytell still could not account for his typewriter's politics, or its dreams.



Overview

Sep 18th 2008
From The Economist print edition

Contagion spread across the financial system on September 17th.

Yields on three-month **Treasury bills** fell that day to 0.02%, their lowest since daily records began in 1954.

Banks scrambled to get hold of funds. The spread of Libor over three-month Treasury bills, often known as the **TED spread**, was 3.02, higher than at any time since the 1987 stockmarket crash.

The **gold price** saw its biggest surge in nine years, rising by $84.67, to $864.42.

Oil prices reversed their precipitous fall of the past two months. WTI climbed $97.16 a barrel, a rise of more than $6 on the day.

The **VIX index**, a measure of the markets' fear, surged by almost six points to 36.22, its highest level since October 2002. Over the past month the index has almost doubled.

World stockmarkets plunged. The MSCI world index has fallen by 5.8% over the past month. **Emerging markets** were hit especially hard. The MSCI emerging-markets index has fallen by 10.5% in the past month.

Russia said it would inject $44 billion into its three largest banks, but it was still obliged to halt trading on its two main stock exchanges.

On September 18th **central banks** around the world pledged to inject as much as $180 billion into banking markets, in a bid to improve short-term funding.



Output, prices and jobs

Sep 18th 2008
From The Economist print edition

Output, prices and jobs

% change on year ago

	Gross domestic product				Industrial production	Consumer prices			Unemployment
	latest	qtr*	2008†	2009†	latest	latest	year ago	2008†	rate‡, %
United States	+2.2 Q2	+3.3	+1.6	+1.3	-1.5 Aug	+5.4 Aug	+2.0	+4.2	6.1 Aug
Japan	+0.7 Q2	-3.0	+1.0	+0.9	+2.4 Jul	+2.3 Jul	nil	+1.6	4.0 Jul
China	+10.1 Q2	na	+9.8	+8.5	+12.8 Aug	+4.9 Aug	+6.5	+6.7	9.5 2007
Britain	+1.4 Q2	+0.2	+1.2	+0.6	-1.9 Jul	+4.7 Aug§	+1.8	+3.7	5.5 Jul††
Canada	+0.7 Q2	+0.3	+1.1	+2.0	-5.9 Jun	+3.4 Jul	+2.2	+2.5	6.1 Aug
Euro area	+1.4 Q2	-0.8	+1.3	+0.9	-1.7 Jul	+3.8 Aug	+1.7	+3.6	7.3 Jul
Austria	+2.2 Q2	+1.5	+2.3	+1.6	-1.1 Jun	+3.7 Aug	+1.7	+3.0	4.2 Jul
Belgium	+1.9 Q2	+0.9	+1.5	+1.1	-3.2 Jun	+5.4 Aug	+1.1	+4.4	11.2 Aug‡‡
France	+1.1 Q2	-1.2	+1.2	+1.0	-2.0 Jul	+3.2 Aug	+1.2	+3.3	7.3 Jul
Germany	+1.7 Q2	-2.0	+1.8	+1.1	-0.6 Jul	+3.1 Aug	+2.2	+3.0	7.6 Aug
Greece	+3.5 Q2	+3.1	+2.8	+2.8	-1.3 Jul	+4.7 Aug	+2.5	+4.6	7.3 Jun
Italy	-0.1 Q2	-1.1	+0.2	+0.5	-3.2 Jul	+4.1 Aug	+1.6	+3.5	6.5 Q1
Netherlands	+2.8 Q2	-0.2	+2.3	+1.3	-2.6 Jul	+3.2 Aug	+1.1	+2.4	3.9 Aug††
Spain	+1.8 Q2	+0.4	+1.4	+0.6	-3.0 Jul	+4.9 Aug	+2.2	+4.5	11.0 Jul
Czech Republic	+4.6 Q2	+3.6	+4.5	+4.9	+6.7 Jul	+6.5 Aug	+2.4	+6.7	5.3 Aug
Denmark	+1.3 Q2	+1.2	+0.8	+0.8	+0.4 Jul	+4.3 Aug	+1.1	+3.5	1.6 Jul
Hungary	+2.0 Q2	+2.3	+2.0	+3.3	+0.6 Jul	+6.5 Aug	+8.3	+6.5	7.5 Jul††
Norway	+5.9 Q2	+2.4	+2.5	+2.2	+1.9 Jul	+4.5 Aug	+0.4	+3.3	2.6 Jun***
Poland	+5.8 Q2	na	+5.4	+4.3	+5.6 Jul	+4.8 Aug	+1.5	+4.2	9.4 Jul‡‡
Russia	+7.8 Q2	na	+7.5	+6.8	+4.7 Aug	+14.7 Jul	+8.7	+14.0	5.3 Jul‡‡
Sweden	+0.7 Q2	-0.1	+1.7	+1.6	+0.9 Jul	+4.3 Aug	+1.8	+3.9	5.2 Aug‡‡
Switzerland	+2.4 Q2	+1.5	+2.0	+1.3	+6.1 Q2	+2.9 Aug	+0.4	+2.7	2.6 Jul
Turkey	+1.9 Q2	na	+4.5	+4.3	+3.4 Jul	+11.8 Aug	+7.4	+11.0	9.0 Q3‡‡
Australia	+2.7 Q2	+1.1	+2.7	+2.6	+2.4 Q1	+4.5 Q2	+2.1	+4.4	4.1 Aug
Hong Kong	+4.2 Q2	-5.5	+4.7	+4.4	-4.2 Q2	+6.3 Jul	+1.5	+5.3	3.2 Jul††
India	+7.9 Q2	na	+7.7	+7.1	+7.1 Jul	+8.3 Jul	+6.5	+7.1	7.2 2007
Indonesia	+6.5 Q2	na	+5.8	+5.5	+1.4 Jul	+11.8 Aug	+5.5	+10.3	8.5 Feb
Malaysia	+6.3 Q2	na	+6.0	+5.6	+1.8 Jul	+8.5 Jul	+1.6	+5.4	3.6 Q1
Pakistan	+5.8 2008**	na	+6.0	+4.4	-4.2 Jun	+25.3 Aug	+6.5	+18.6	5.6 2007
Singapore	+2.1 Q2	-6.0	+4.0	+3.8	-21.9 Jul	+6.5 Jul	+2.6	+6.5	2.3 Q2
South Korea	+4.8 Q2	+3.4	+4.4	+4.2	+9.1 Jul	+5.6 Aug	+2.0	+4.2	3.2 Aug
Taiwan	+4.3 Q2	na	+4.3	+4.4	+1.1 Jul	+4.8 Aug	+1.6	+3.4	3.9 Jul
Thailand	+5.3 Q2	+2.9	+4.8	+3.9	+10.9 Jul	+6.4 Aug	+1.1	+6.4	1.2 Jun
Argentina	+8.4 Q1	+2.4	+6.0	+3.5	+5.1 Jul	+9.0 Aug	+8.7	+9.3	7.8 Q3‡‡
Brazil	+6.1 Q2	+6.6	+4.6	+3.4	+8.5 Jul	+6.2 Aug	+4.2	+6.0	8.1 Jul‡‡
Chile	+4.3 Q2	+7.4	+3.6	+3.6	+3.0 Jul	+9.3 Aug	+4.7	+8.6	8.4 Jul††‡‡
Colombia	+4.1 Q1	-3.7	+4.5	+4.0	+0.7 Jul	+7.9 Aug	+5.2	+6.7	11.0 Jul‡‡
Mexico	+2.8 Q2	+0.6	+2.3	+2.5	-0.5 Jun	+5.6 Aug	+4.0	+4.8	4.2 Jul‡‡
Venezuela	+7.1 Q2	na	+5.2	+3.0	-2.5 Jun	+34.5 Aug	+16.0	+30.6	7.5 Q2‡‡
Egypt	+6.6 Q2	na	+7.1	+6.7	+7.5 2007**	+23.7 Aug	+8.1	+17.1	9.0 Q1‡‡
Israel	+4.9 Q2	+4.2	+4.0	+3.2	+18.7 Jun	+5.0 Aug	+1.0	+4.3	5.9 Q2
Saudi Arabia	+3.5 2007	na	+7.2	+5.1	na	+11.1 Jul	+3.8	+8.5	na
South Africa	+4.5 Q2	+4.9	+3.2	+3.5	+3.3 Jul	+13.4 Jul	+7.0	+10.3	23.1 Jun‡‡
MORE COUNTRIES Data for the countries below are not provided in printed editions of *The Economist*									
Estonia	-1.1 Q2	-3.2	-0.6	+2.0	-5.2 Jul	+11.0 Aug	+5.7	+10.5	4.0 Jul
Finland	+2.4 Q2	+3.1	+2.8	+2.4	-1.4 Jul	+4.7 Aug	+2.3	+3.8	6.4 Jul
Iceland	+5.0 Q2	+20.9	nil	+0.8	+0.4 2007	+14.5 Aug	+3.4	+12.0	1.2 Aug‡‡
Ireland	-1.5 Q1	-0.9	-0.5	-0.1	-4.5 Jul	+4.3 Aug	+4.8	+4.0	6.1 Aug
Latvia	+0.1 Q2	na	-0.4	+0.5	-6.9 Jul	+15.7 Aug	+10.1	+15.8	5.7 Jul
Lithuania	+5.3 Q2	+4.5	+5.5	+4.8	na	+11.9 Aug	+5.6	+11.0	4.7 Aug‡‡
Luxembourg	+2.5 Q1	+5.3	+2.8	+2.6	+7.5 Jul	+4.0 Aug	+1.9	+4.0	4.1 Jul‡‡
New Zealand	+0.9 Q1	-2.3	+0.7	+1.6	+2.4 Q1	+4.0 Q2	+2.0	+4.1	3.9 Q2
Peru	+8.3 Jul	na	+7.9	+6.6	+7.0 Jul	+6.3 Aug	+2.2	+5.3	9.2 Jul††
Philippines	+4.6 Q2	+8.4	+4.7	+5.4	+5.1 Jun	+12.5 Aug	+2.4	+9.6	7.4 Q3‡‡
Portugal	+0.7 Q2	+1.4	+1.4	+1.3	-0.4 Jul	+3.0 Aug	+2.0	+2.7	7.3 Q2‡‡
Slovakia	+7.6 Q2	na	+7.5	+5.2	+1.8 Jul	+5.0 Aug	+2.3	+4.2	7.5 Jul††
Slovenia	+5.5 Q2	na	+4.5	+4.0	-4.6 Jul	+6.0 Aug	+3.5	+6.0	6.5 Jul‡‡

*% change on previous quarter, annual rate. †*The Economist* poll or Economist Intelligence Unit estimate/forecast. ‡National definitions.- §RPI inflation rate4.8% in Aug. **Year ending June. ††Latest three months. ‡‡Not seasonally adjusted. ***Centred 3-month average

Sources: National statistics offices and central banks; Thomson Datastream; Reuters; Centre for Monitoring Indian Economy; OECD; ECB

The Economist commodity-price index

Sep 18th 2008
From The Economist print edition

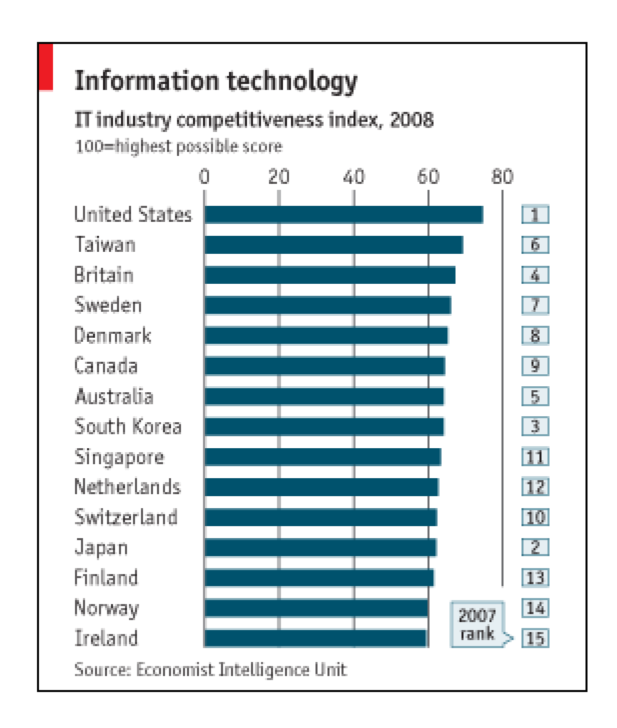
***The Economist* commodity-price index**
2000=100

	Sep 9th	Sep 16th*	% change on one month	% change on one year
Dollar index				
All items	226.6	219.7	-7.7	+4.9
Food	230.8	223.7	-8.4	+15.3
Industrials				
All	221.3	214.6	-6.8	-6.5
Nfa†	186.3	177.6	-5.6	+9.7
Metals	240.4	234.9	-7.3	-11.8
Sterling index				
All items	194.8	187.8	-3.2	+18.0
Euro index				
All items	148.3	143.9	-3.9	+3.0
Gold				
$ per oz	811.00	777.40	-2.8	+8.7
West Texas Intermediate				
$ per barrel	102.28	93.22	-18.6	+13.6

*Provisional †Non-food agriculturals.

Information technology

Sep 18th 2008
From The Economist print edition



America remains the most congenial country for information-technology firms, according to an index compiled by the Economist Intelligence Unit, a sister company of *The Economist*. The index rates 66 countries—the top 15 of which are shown—on the support they provide for a competitive IT industry in six broad areas that include research and development, human capital and legal systems. Taiwan's move since last year from sixth to second place has been helped by a particularly strong score on R&D. America does less well on R&D, but continues to lead the pack because of its excellent performance in the five other dimensions, such as its ability to develop talent and robust legal protection of intellectual property.

Trade, exchange rates, budget balances and interest rates

Sep 18th 2008
From The Economist print edition

Trade, exchange rates, budget balances and interest rates

	Trade balance* latest 12 months, $bn	Current-account balance latest 12 months, $bn	Current-account balance % of GDP 2008†	Currency units, per $ Sep 17th	Currency units, per $ year ago	Budget balance % of GDP 2008†	Interest rates, % 3-month latest	Interest rates, % 10-year gov't bonds, latest
United States	−844.6 Jul	−699.0 Q2	−4.8	–	–	−2.5	2.04	3.41
Japan	+88.2 Jul	+206.4 Jul	+3.7	105	116	−2.8	0.75	1.49
China	+252.5 Aug	+371.8 2007	+8.3	6.84	7.51	0.6	4.29	3.82
Britain	−187.4 Jul	−102.4 Q1	−3.4	0.56	0.50	−3.8	5.90	4.40
Canada	+49.3 Jul	+13.6 Q2	+0.9	1.08	1.02	0.2	2.37	3.47
Euro area	−10.8 Jul	−31.5 Jun	−0.3	0.70	0.72	−0.9	4.97	4.01
Austria	+0.1 Jun	+14.8 Q1	+2.9	0.70	0.72	−0.8	4.97	4.28
Belgium	+5.5 Jun	−1.1 Mar	+0.7	0.70	0.72	−0.6	5.04	4.48
France	−71.9 Jul	−51.3 Jul	−1.7	0.70	0.72	−2.9	4.97	4.29
Germany	+284.9 Jul	+271.9 Jul	+6.7	0.70	0.72	1.1	4.97	4.01
Greece	−66.6 Jun	−49.9 Jun	−13.9	0.70	0.72	−2.6	4.97	4.85
Italy	−13.9 Jun	−67.6 Jun	−2.6	0.70	0.72	−2.6	4.97	4.77
Netherlands	+61.4 Jul	+50.7 Q1	+5.8	0.70	0.72	0.7	4.97	4.28
Spain	−153.4 Jun	−167.3 Jun	−9.8	0.70	0.72	−1.6	4.97	4.52
Czech Republic	+6.1 Jul	−4.8 Jul	−2.7	17.0	19.8	−1.8	3.80	4.23
Denmark	+5.1 Jul	+3.9 Jul	+1.1	5.26	5.34	3.8	5.45	4.36
Hungary	+0.5 Jul	−7.2 Q1	−5.9	172	180	−4.0	8.64	7.80
Norway	+80.5 Aug	+78.1 Q2	+17.3	5.89	5.58	17.7	6.47	4.38
Poland	−19.7 Jul	−22.0 Jul	−4.9	2.37	2.70	−1.9	6.60	5.84
Russia	+182.7 Jul	+109.8 Q2	+6.2	25.6	25.2	4.5	11.00	8.15
Sweden	+19.0 Jul	+38.6 Q2	+7.7	6.79	6.62	2.4	4.29	3.73
Switzerland	+16.4 Aug	+91.4 Q1	+14.5	1.12	1.19	0.9	2.73	2.73
Turkey	−73.8 Jul	−47.1 Jul	−6.4	1.28	1.23	−2.7	18.29	7.17‡
Australia	−18.6 Jul	−61.1 Q2	−5.1	1.27	1.17	1.3	7.26	#REF!
Hong Kong	−26.3 Aug	+26.4 Q1	+9.0	7.78	7.79	3.0	2.24	2.53
India	−93.3 Jul	−17.5 Q1	−3.2	46.3	40.2	−3.4	8.71	8.63
Indonesia	+35.6 Jul	+6.3 Q2	+2.8	9,400	9,225	−2.0	10.84	7.54‡
Malaysia	+39.7 Jul	+30.6 Q1	+14.4	3.45	3.46	−3.1	3.70	3.52‡
Pakistan	−21.7 Aug	−14.0 Q2	−8.6	77.2	60.6	−6.4	13.89	16.33‡
Singapore	+25.5 Aug	+32.8 Q2	+20.3	1.43	1.51	1.0	1.38	2.82
South Korea	−7.5 Aug	−1.8 Jul	−2.5	1,116	927	1.5	5.78	5.74
Taiwan	+9.3 Aug	+32.6 Q2	+5.2	32.1	33.1	−1.8	2.73	2.13
Thailand	+6.8 Jul	+11.4 Jul	+1.1	34.4	34.3	−2.9	3.85	4.29
Argentina	+11.3 Jul	+7.9 Q1	+3.1	3.10	3.13	0.7	13.69	na
Brazil	+29.5 Aug	−19.5 Jul	−1.6	1.86	1.86	−1.6	13.66	6.16‡
Chile	+17.8 Aug	+1.0 Q2	−0.3	546	513	6.5	8.16	3.71‡
Colombia	+1.2 Jun	−5.0 Q1	−2.6	2,132	2,056	−1.0	10.10	6.51‡
Mexico	−8.2 Jul	−5.3 Q2	−0.8	10.9	11.0	−0.1	8.16	8.70
Venezuela	+41.9 Q2	+37.8 Q2	+12.1	4.95	4.23§	1.6	17.02	6.55‡
Egypt	−22.2 Q1	−0.1 Q1	+0.2	5.48	5.62	−7.1	13.22	5.31‡
Israel	−13.1 Aug	+3.5 Q2	+0.2	3.53	4.07	−1.0	4.16	5.40
Saudi Arabia	+150.8 2007	+95.0 2007	+33.1	3.75	3.75	13.3	4.34	na
South Africa	−11.1 Jul	−22.5 Q2	−8.0	8.20	7.06	0.4	12.20	9.06
MORE COUNTRIES Data for the countries below are not provided in printed editions of *The Economist*								
Estonia	−4.2 Jun	−3.4 Jul	−10.8	11.0	11.2	−0.4	6.33	na
Finland	+12.2 Jul	+11.5 Jul	+4.5	0.70	0.72	4.5	4.91	4.25
Iceland	−1.0 Aug	−4.5 Q2	−14.6	94.7	63.2	2.0	15.97	na
Ireland	+38.2 Jun	−14.7 Q1	−3.5	0.70	0.72	−3.9	4.97	4.46
Latvia	−7.1 Jul	−5.7 Jul	−13.8	0.50	0.51	−1.5	5.68	na
Lithuania	−7.9 Jul	−5.9 Jul	−14.0	2.43	2.47	−0.7	5.74	na
Luxembourg	−6.7 Jun	+4.9 Q1	na	0.70	0.72	0.5	4.97	na
New Zealand	−3.3 Jul	−10.4 Q1	−7.1	1.52	1.36	1.2	7.35	5.76
Peru	+6.3 Jul	−1.5 Q2	−1.1	2.98	3.13	2.3	6.55	na
Philippines	−8.2 Jun	+5.6 Mar	+2.8	47.1	45.6	−0.8	4.00	na
Portugal	−31.9 Jun	−27.9 Jun	−9.0	0.70	0.72	−2.5	4.97	4.59
Slovakia	−1.2 Jul	−5.0 May	−4.7	21.3	24.2	−2.1	3.77	4.89
Slovenia	−4.3 Jul	−3.2 Jun	−5.8	0.70	0.72	0.1	4.97	na

*Merchandise trade only. †*The Economist* poll or Economist Intelligence Unit forecast. ‡Dollar-denominated bonds. §Unofficial exchange rate.
Sources: National statistics offices and central banks; Thomson Datastream; Reuters; JPMorgan; Bank Leumi le-Israel; Centre for Monitoring Indian Economy; Danske Bank; Hong Kong Monetary Authority; Standard Bank Group; UBS; Westpac.



Markets

Sep 18th 2008
From The Economist print edition

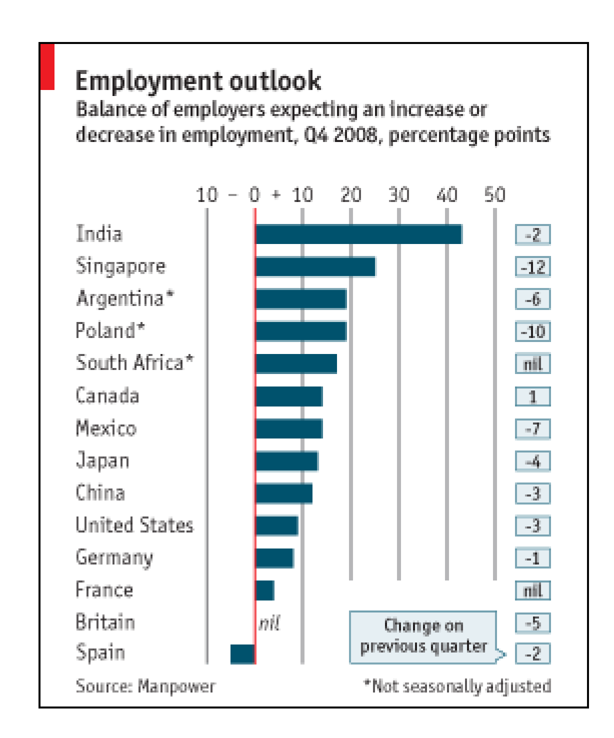
Markets

	Index	% change on		
			Dec 31st 2007	
	Sep 17th	one week	in local currency	in $ terms
United States (DJIA)	10,609.7	−5.9	−20.0	−20.0
United States (S&P 500)	1,156.4	−6.1	−21.2	−21.2
United States (NAScomp)	2,098.9	−5.8	−20.9	−20.9
Japan (Nikkei 225)	11,749.8	−4.8	−23.2	−18.1
Japan (Topix)	1,121.4	−6.0	−24.0	−18.9
China (SSEA)	2,025.6	−10.3	−63.3	−60.8
China (SSEB, $ terms)	115.3	−19.6	−70.5	−68.5
Britain (FTSE 100)	4,912.4	−8.5	−23.9	−31.4
Canada (S&P TSX)	11,877.7	−5.0	−14.1	−21.3
Euro area (FTSE Euro 100)	941.5	−6.6	−31.5	−33.5
Euro area (DJ STOXX 50)	3,018.8	−6.9	−31.4	−33.4
Austria (ATX)	2,939.2	−10.9	−34.9	−36.8
Belgium (Bel 20)	2,789.0	−8.7	−32.4	−34.4
France (CAC 40)	4,000.1	−6.6	−28.7	−30.8
Germany (DAX)*	5,861.0	−5.6	−27.3	−29.5
Greece (Athex Comp)	2,957.9	−8.0	−42.9	−44.6
Italy (S&P/MIB)	25,920.0	−7.6	−32.8	−34.7
Netherlands (AEX)	357.0	−9.4	−30.8	−32.8
Spain (Madrid SE)	1,144.7	−5.0	−30.3	−32.3
Czech Republic (PX)	1,187.6	−10.2	−34.6	−30.1
Denmark (OMXCB)	345.3	−5.3	−23.1	−25.3
Hungary (BUX)	17,889.3	−10.7	−31.8	−31.6
Norway (OSEAX)	380.0	−8.7	−33.3	−38.5
Poland (WIG)	36,431.5	−7.9	−34.5	−32.0
Russia (RTS, $ terms)	1,058.8	−20.6	−51.9	−53.8
Sweden (Aff.Gen)	240.3	−7.7	−29.4	−32.8
Switzerland (SMI)	6,654.3	−6.6	−21.6	−20.6
Turkey (ISE)	32,727.6	−16.7	−41.1	−46.1
Australia (All Ord.)	4,769.7	−3.9	−25.7	−33.3
Hong Kong (Hang Seng)	17,637.2	−11.8	−36.6	−36.5
India (BSE)	13,262.9	−9.5	−34.6	−44.4
Indonesia (JSX)	1,769.9	−6.1	−35.5	−35.6
Malaysia (KLSE)	1,003.0	−5.6	−30.6	−33.6
Pakistan (KSE)	9,216.2	−1.1	−34.5	−47.8
Singapore (STI)	2,419.3	−7.7	−30.2	−30.0
South Korea (KOSPI)	1,425.3	−2.7	−24.9	−37.0
Taiwan (TWI)	5,800.9	−10.2	−31.8	−31.1
Thailand (SET)	605.1	−7.7	−29.5	−30.8
Argentina (MERV)	1,492.0	−7.0	−30.7	−29.5
Brazil (BVSP)	45,908.0	−7.5	−28.1	−31.4
Chile (IGPA)	12,773.0	−1.9	−9.3	−17.3
Colombia (IGBC)	9,009.5	−6.1	−15.8	−20.3
Mexico (IPC)	23,456.8	−8.5	−20.6	−20.2
Venezuela (IBC)	39,254.1	−2.1	+3.6	−55.1
Egypt (Case 30)	7,420.2	−10.2	−29.1	−28.6
Israel (TA-100)	767.6	−13.2	−33.5	−27.5
Saudi Arabia (Tadawul)	7,387.3	−9.1	−33.1	−33.1
South Africa (JSE AS)	24,323.2	−3.8	−16.0	−30.0
Europe (FTSEurofirst 300)	1,070.1	−6.8	−29.0	−31.0
World, dev'd (MSCI)	1,191.4	−5.8	−25.0	−25.0
Emerging markets (MSCI)	768.9	−10.5	−38.3	−38.3
World, all (MSCI)	296.1	−6.3	−26.6	−26.6
World bonds (Citigroup)	754.2	+1.7	+3.3	+3.3
EMBI+ (JPMorgan)	413.1	−5.7	−4.7	−4.7
Hedge funds (HFRX)	1,216.2	−1.4	−8.5	−8.5
Volatility, US (VIX)	36.2	24.5	22.5	(levels)
CDSs, Eur (iTRAXX)†	143.8	+41.3	+184.1	+175.8
CDSs, N Am (CDX)†	216.0	+32.2	+177.3	+177.3
Carbon trading (EU ETS) €	23.3	+2.6	+4.8	+1.8

*Total return index. †Credit-default swap spreads, basis points.
Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Reuters; WM/Reuters; JPMorgan Chase; Bank Leumi le-Israel; CBOE; CMIE; Danske Bank; EEX; HKMA; Markit; Standard Bank Group; UBS; Westpac.

Employment outlook

Sep 18th 2008
From The Economist print edition



Despite worries about the economic impact of the banking crisis on jobs, an international survey from Manpower, an employment-services firm, shows that in most countries a majority of employers are planning to increase their payrolls in the final quarter of 2008. Prospects are bright in emerging economies, especially India, where the percentage of employers planning to hire more staff exceeds that of those intending to shed labour by 43 points. The outlook is duller in the United States and Europe. Indeed in Spain, the share of employers intending to cut staff outweighs that of would-be hirers by five points. Compared with intentions for the third quarter of the year, however, the outlook has generally become gloomier.